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The American University in Cairo

School of Global Affairs and Public Policy

WOMEN-OWNED MSMEs AND FINANCIAL INCLUSION IN EGYPT

A Thesis Submitted to the

Public Policy and Administration Department

**in partial fulfillment of the requirements for the degree of
Master of Public Administration**

By

Noheir Ahmed Khairy

Fall 18

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List of Acronyms

AFI	Alliance for Financial Inclusion
CBE	Central Bank of Egypt
FRA	Financial Regulatory Authority
GDP	Gross Domestic Product
GPFI	Global Partnership for Financial Inclusion
IFC	International Finance Corporation
ILO	International Labour Organization
INFE	International Network on Financial Education
INGO	International Non-Governmental Organization
MFW4A	Making Finance Work for Africa
MFIs	Microfinance Institutions
MENA	Middle East and North Africa
MSMEs	Micro, small and medium enterprises
NGOs	Non-Governmental Organizations
OECD	Organization for Economic Cooperation and Development
OECD/INFE	Organization for Economic Cooperation and Development/ International Network on Financial Education
PCB	Private Credit Bureau
PCR	Public Credit Registry
SMEs	Small and medium enterprises
WBG	World Bank Group

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The American University in Cairo
School of Global Affairs and Public Policy
WOMEN-OWNED MSMEs AND FINANCIAL INCLUSION IN EGYPT

By

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Supervised by

Dr. Khaled Abdelhalim

ABSTRACT

In Egypt, Micro Small and Medium Enterprises (MSMEs) play a crucial role in the economy, with their contribution to Gross Domestic Product (GDP) and employment. Despite being the backbone of the economy, they are constantly confronted with challenges in the business environment. Primary amongst these challenges is limited access to formal financial capital at an affordable interest rate leading them to depend on other sources of finance like savings and informal financial services. Women-owned MSMEs especially, have been found to face more challenges in terms of financial accessibility and exclusion from the formal financial market. This work highlights the extent of financial inclusion in Egypt with respect to not only access, but also usage and quality of financial service problems faced by MSMEs in general and women-owned businesses in particular. The analysis of the study follows the comprehensive framework of financial inclusion including access, usage and quality of financial products and services. The findings of this research reveal that while women-owned MSMEs face certain challenges similar to those of their male-owned counterparts, the severity of their challenges is more pronounced by virtue of them being women-owned. Specific constraints faced by women includes risk aversion of banks, lack of financial services and products targeting women-owned MSMEs, lack of collateral and low levels of financial awareness and financial literacy. Whilst a number of interventions have been put in place by the Central Bank of Egypt (CBE) and the Financial Regulatory Authority (FRA) to address the issue of financial inclusion within the MSME sector, most of them do not take gender into consideration. The study recommends continuing supporting MSMEs financial inclusion especially women-owned MSMEs through addressing non-price barriers like supporting a secured collateral framework, raising the capabilities of financial institutions to better serve women-owned MSMEs and focusing on raising financial awareness and literacy among women-owned MSMEs.

Chapter One: Introduction

Finance is an integral part of the development process; which is why development efforts are focusing on the efficiency and the functioning of financial systems (Demirgüç-Kunt, Beck, and Honohan, 2008). Empirical evidence has shown that well-functioning financial systems promote economic growth, enhance income distribution and reduce poverty (ibid). This is because well-functioning financial systems enable funds to be used in the most productive ways and help in allocating risks to entities or individuals who have the tools and the resources to bear them (ibid). When access to financial services are limited, the benefits of financial development do not reach many individuals and enterprises, which puts a high percentage of the population in absolute poverty (ibid).

Financial inclusion has received a lot of importance in academic research, this is due to the shifting role assumed by financial regulators who are in need of academic resources to support their recent paths towards economic development (Ardic, Heimann and Mylenko, 2011). Financial regulators' roles are expanding beyond monitoring and supervision and ensuring soundness and safety of the financial system (ibid). Recently, financial regulators are placing financial inclusion on top of their agenda as a tool for financial sector reform and are working on the expansion of financial access (ibid). As pointed out by Demirgüç-Kunt et al, (2008), the establishment of an inclusive financial system is a goal that most economies at different developmental levels are trying to achieve. Access to financial services encompasses more than access to basic financial services by as many people as possible (ibid). Inclusive financial access addresses the quality and outreach of a wide range of financial services including credit, savings, payments and insurance services (ibid). This

is done with the aim of enabling growth and productivity more specifically for small and medium scale enterprises (ibid).

Small and medium enterprises (SMEs) are considered the backbone of most economies because they account for a large share of businesses in the private sector, and a large share of national employment (Beck, 2007). This is further supported by a study by Ayyagari, Demirguc-Kunt and Maksimovic (2011) which reinforces the importance of small firms in generating employment, despite facing constraints, which affects their growth and productivity. Among the main constraints are a non-supporting regulatory and supervisory framework coupled with poor financial infrastructure, and a weak outreach of financial intermediaries to SMEs (ibid).

Micro, small and medium enterprises (MSMEs) play an even more important role in the economies of the Middle East and North Africa (MENA) region with their significant contribution to employment. Indeed, SMEs employ more than 30 percent of all private sector workers and between 4 percent and 16 percent of total employment, which includes employment in public sector and public sector and non-governmental organizations (NGOs) (Nasr & Pearce, 2012). Notwithstanding their importance, MSMEs still face problems in accessing financial services that suit their business start-up, operating and expansion needs (ibid). Policy makers are in search for tools and solutions to improve the financial environment for MSMEs to further enhance their overall development (ibid). Financial inclusion is one of the tools that can help make growth in the MENA countries more inclusive, especially for women and the increasing youth population (ibid).

A strand of the literature points to the existence of a gender gap in financial inclusion, as outlined by Demirgüç-Kunt et al., (2008), whereby women in the developing world are faced with barriers when accessing the formal banking services as compared to their male counterparts. Another study

by Demirgüç-Kunt, Klapper and Singer (2013) reports on the gender gap in the use of formal and informal financial services which results in women being excluded from the formal financial system due to a number of reasons that include rigid requirements by the financial institutions. In the same vein, a study by Saviano, Nenci and Caputo (2017) addressing the financial gap for women in the MENA region shows that women's opportunities to receive financial support to start and grow their businesses are less than those of men.

A study by the International Finance Corporation and Global partnership for Financial Inclusion (IFC & GPFI, 2011) states that factors contributing to the lagging growth of women-owned MSMEs are regulatory, institutional challenges, lack of access to finance, low levels of business education and work experience, in addition to women being risk averse and limiting their businesses to sectors with slow growth. However, access to finance remains the major constraint that was frequently identified as facing women entrepreneurs (Saviano et al., 2017)

Female entrepreneurship is considered an instrumental tool for poverty reduction. Evidence from prior studies (e.g. Pitt & Khandor, 1998) suggest a positive correlation between income gained by female entrepreneurs and the level of household expenditure and consumption. This is because females use a larger percentage of their income on the household consumption and expenditure (ibid). One can surmise therefore, that if women-owned enterprises grow, we would see a significant increase in household welfare (Kairiza, Kiprono, & Magadzire, 2016). Gender inequalities among entrepreneurs in terms of the degree of financial inclusion, as represented in access and use of financial services including saving, borrowing and managing risk, has been proposed as one of the factors explaining the reason behind the underperformance of women-owned businesses (Allen, Demirguc-Kunt, Klapper, & Peria, 2016). With the success of Grameen and other microfinance schemes which mainly focused on women's credit, policy makers are

searching for ways to promote economic activity and growth for women (Pines, Lerner & Schwartz, 2010). Despite the value of female entrepreneurship and its role in promoting growth and reducing poverty, little is known about the role of female entrepreneurs, their opportunities and barriers affecting them (Klapper & Parker, 2011)

Considering the importance of financial inclusion of women-owned MSMEs in Egypt, this study explores this domain in Egypt, exploring the barriers to expanded financial inclusion and ways by which the Egyptian government, more specifically central bank and financial regulatory and supervisory authorities are addressing these barriers and promoting financially inclusive markets.

1.1 Background

1.1.1 Overview of the Financial Market in Egypt

In a recent report on financial inclusion and development, Alshyab et al., (2018) mentioned that the most dominant financial institutions in Egypt are banks controlling most of the financial assets and financial transactions. The Central Bank of Egypt (CBE) is the supervisor of the banking sector in Egypt which consists of commercial, investment and specialized banks, while the non-banking financial institutions in Egypt are regulated by the Egyptian Financial Regulatory Authority (FRA) formerly known as EFSA (Egyptian Financial Supervisory Authority) (ibid). Non-banking financial services in Egypt include stock exchange, leasing companies, insurance companies, mortgage finance and factoring companies, with the exception of the stock exchange all other non-banking financial services are at a primitive phase (ibid). Figure 1 shows an overview of the financial market composition in Egypt.

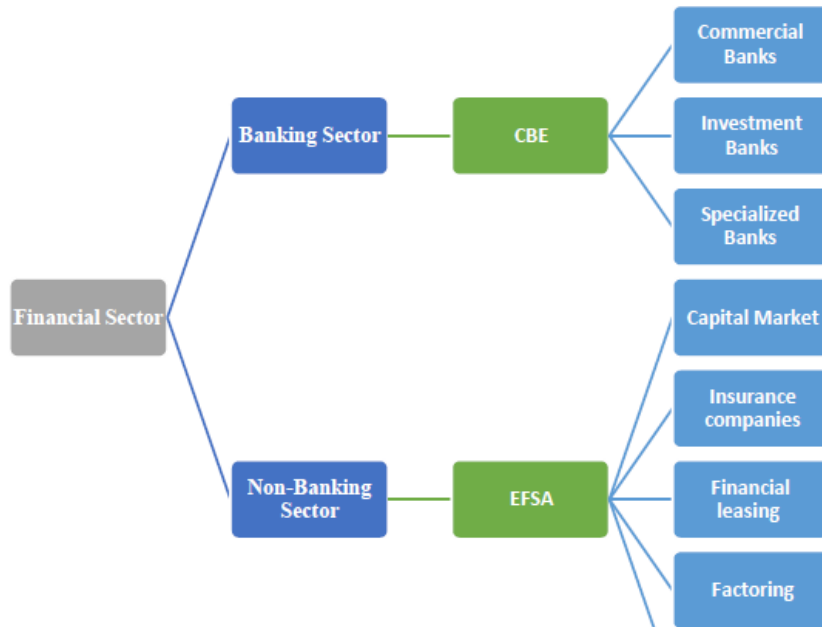


Figure 1: Overview of the Financial Market in Egypt

Source Alshyab et al., 2018 p. 17

There are thirty-eight (38) banks in Egypt (without counting the CBE) according to a recent study by the Arab Women's Enterprise Fund (Gueguen, 2018; Alshyab et al., 2018). As for the capital market, the Egyptian stock exchange is the only entity for stock exchange in Egypt (Alshyab et al., 2018). The insurance market in Egypt is an underdeveloped market as the case of other non-banking financial services (Nasr, 2010). There are currently 36 insurance companies operating in the market, one cooperative insurance company, and the Export Credit Guarantee Company of Egypt (ECGC) (Gueguen, 2018). Despite of the development of mortgage finance in Egypt, it still represents a small proportion of the financial market, with most finance going for purchasing houses (Alshyab et al., 2018).

Financial leasing and factoring is also at a primitive state and used on a limited scale, despite being an important tool for SMEs and startups (Alshyab et al., 2018). Leasing allow companies to use

the asset without buying it this through leasing it from the owner for a certain period of time in exchange for a series of payments (OECD/INFE, 2015).

According to Gueguen (2018), state-owned specialized financial institutions in Egypt are Egyptian National Post Office (ENPO), The Micro, Small and Medium Enterprise Development Agency (MSMEDA), and the Agriculture Bank of Egypt (formerly known as ex-Principle Bank for Development and Agricultural Credit -PBDAC). Low-income population mainly depend on ENPO for savings with more than 25 million saving accounts (ibid). MSMEDA offer loans to MSMEs either directly or indirectly through Microfinance Institutions (MFIs), banks and NGOs, while the Agriculture Bank of Egypt is a public bank with specialization in agriculture mainly focusing on rural areas (ibid).

1.1.2 Background on MSMEs in Egypt

A general guideline for defining MSMEs in Egypt as provided by the CBE in 2015¹ (updated in March, 2017²) is displayed in Table One below

Companies and Enterprises	Established (in business)		NEW (newly established)	
	Volume of the business	Number of Employees*	Paid in Capital*	Number of Employees*

¹ <http://www.cbe.org.eg/en/Pages/HighlightsPages/Circulardated7122015e.aspx>

² <http://www.cbe.org.eg/en/Pages/HighlightsPages/Circular-dated-5-March-2017-regarding-amending-some-items-of-the-SMEs-initiatives.aspx>

	(sales/annual revenues			
Micro	Less than 1 million Egyptian Pounds (EGP)	Less than 10 individuals	Less than 50,000 EGP	Less than 10 individuals
Small	From 1 million EGP to less than EGP 50 million EGP	Less than 200 individuals	From 50,000 EGP to less than 5 million EGP for industrial companies or to less than 3 million for non-industrial companies	Less than 200 individuals
Medium	From 50 million EGP to 200 million EGP		From 5 million EGP to 15 million EGP for industrial companies- from 3 million EGP to 5 million EGP for non-industrial companies	

Table 2: Definition of MSMEs

Source: CBE (2017)

*number of Employees: for guidance purposes only and not to be used to classify or define the size company or the enterprise

* paid in capital to be used for new businesses only, to be used instead of annual revenues for one year only until the business has information about its annual revenues, then this classification will be temporary until annual revenues are used as per the original definition

According to CBE (2017) as cited in Alshyab et al., (2018), microenterprises dominate the Egyptian private sector representing 91 percent of all enterprises in Egypt, small and medium ones represent 8% and large enterprises representing 1%. This is a phenomenon called “the missing middle” which is described by Loewe et al., (2013) referring to countries like Egypt which have a huge number of micro and small businesses, rare medium-sized segment and very few large businesses which have no links to smaller ones. The low number of medium-sized companies were partially explained by the obstacles small firms face in growing to be medium ones and difficulties facing newly upgraded medium ones to maintain their current status-being medium instead of small (ibid)

By virtue of their informality, most microbusiness in Egypt have limited potential for expansion. They face a wide array of structural weaknesses including but not limited to lack of financial resources and are unable to sufficiently benefit from governmental efforts geared towards their development (Saif & Ghoneim, 2013).

In terms of sectoral distribution, most MSMEs operate in the manufacturing and trade sectors depicted in **Figure 2**. Because they are more labor intensive, MSMEs contribute to employment

creation in Egypt by employing more than 75% of total private sector employment both through formal and informal businesses and contributing to 80% of the GDP

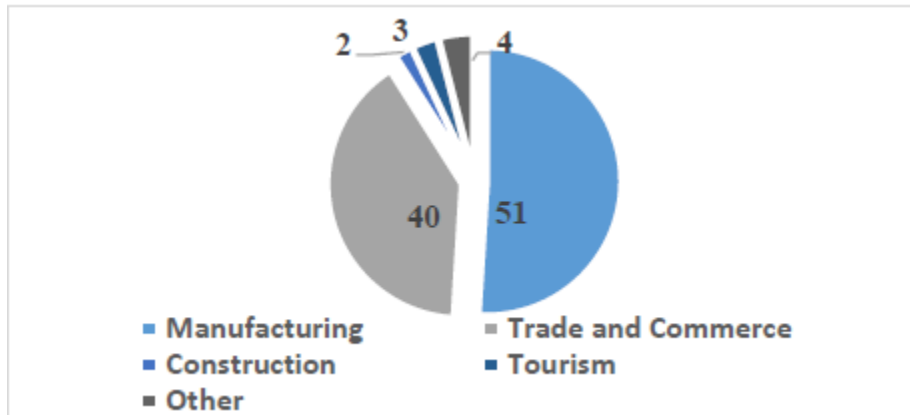


Figure 2: Distribution of MSMEs by Sector in Egypt

Source: IFC (2014) as cited in Ayadi et al., (2017, P. 25)

1.3.3 Background on Women-owned MSMEs in Egypt

The Central Bank of Egypt has recently issued a definition of women-owned businesses according to circular dated 16 August 2018³. A business is considered a women-owned business if 51 percent of the capital of the company is owned by one or more women, or if 20% of the capital of the company is owned by one or more woman and a woman is holding the position of chief executive officer or vice president of the chief executive officer.

According to the International Labour Organization (ILO, 2016), businesses owned and operated by women are mostly in the informal sector, working alone without engagement of other employees, as many of those women establish micro scale businesses operated from home

³ Women-owned MSMEs definition: <http://www.cbe.org.eg/en/Pages/HighlightsPages/Circular-dated-16-August-2018-regarding-Women-Owned-Business-Definition.aspx>

especially in agriculture sector. As per figure 4 below, women entrepreneurs mainly work in the agriculture sector with the highest concentration of 58% followed by wholesale and retail trade (32%) with the lowest concentration in manufacturing being 3%. Businesses owned by women in Egypt are concentrated in rural areas, as they represent 82% of women business owners, most of women-owned businesses are microenterprises depending on MFIs as source of external finance, women-owned enterprises which are small in size are few in numbers, and women-owned enterprises which are medium sized are scarce (ILO, 2016).

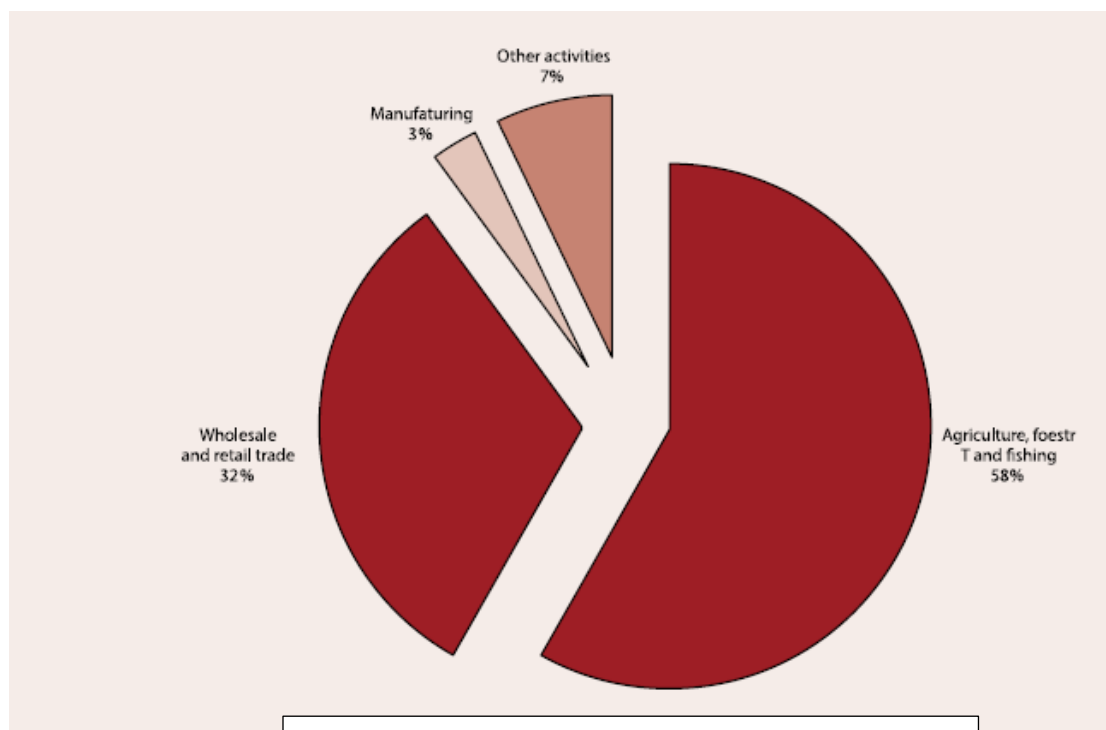


Figure 3: Sectoral distribution of women entrepreneurs in Egypt

Source: ILO (2016, P. 8) Calculations based on CAPMAS statistics. 2014. “Annual bulletin for labor force survey 2014”.

1.4 Rationale for conducting this thesis

A study by Nasr, Helmy and Ali (2018) on Egypt’s digital financial services notes that financial inclusion has become one of Egypt’s national objectives, since the launch of Egypt’s Sustainable

Development Strategy (SDS): Egypt's Vision 2030. As a focus area of the country's sustainable development strategy, financial inclusion can help Egypt achieve its main goals of inclusive growth and financial and social stability (ibid). Due to the highlighted importance of financial inclusion, the Central Bank of Egypt (CBE) considers financial inclusion one of its main strategic objectives and is working as the main governmental body responsible for the promotion and coordination of financial inclusion efforts (ibid).

A large proportion of MSMEs in Egypt were found to have problems related to access to formal financial services, which forces them to depend on the informal market (demand side study referenced in Nasr et al., (2018)). Women were also found to be more excluded from the formal financial system (ibid). This was also referred to in a study by Nasr (2011), which points out that although access to finance is a challenge for both men and women businesses, women are far more constrained especially on the small and medium enterprise levels (ibid). Women reportedly face much stricter constraints when it comes to the cost and access to financial services. This is one of the reasons that make women more active in the informal credit market, resorting to borrowing money from friends and family (Nasr, n.d), According to the ILO (2016) among countries in the MENA region and Sub Saharan Africa, Egypt had the lowest percentage of women entrepreneurs during the past few years. Compared to then MENA region, the percentage of women at the beginning stage of entrepreneurship was 2% in Egypt (ibid). Generally, women were found to be less entrepreneurially active than men (ibid), resulting in Egypt having the highest gender gap amongst all MENA countries (Hattab, 2012).

Governments in the MENA region are working extensively on economic development plans focusing on the advancement of women's economic integration. However, these policies have not received full attention in terms of researching their synergies, their effects and how to enhance

them to achieve their full potential. One of the areas in which governments' intervention needs to be addressed is access to finance for women, as women are considered a primary target group for micro-finance but do not receive support in other areas of the business environment (Bahramitash & Esfahani, 2016).

Despite the Egyptian government's focus on MSMEs, much of its efforts have disregarded gender related challenges. According to the ILO (2016), women in Egypt encounter significant challenges among which is lack of access to financial services. In effect, 99% of Egyptian women business owners claim that credit conditions are too rigid and comes with highest costs as per a survey done by MENA Business Women's Network (BWN, 2013)⁴. Supporting women's businesses can lead to positive outcomes for the whole country, including gender equality, creation of more jobs, economic growth and reduction in poverty (ILO, 2016). Despite the significant contribution of women's business, gender gaps are evident in areas of entrepreneurial activities and business ownership (ibid)

This study will be focusing on the role played by central bank and financial supervisory and regulatory authorities in expanding financial inclusion of women-owned MSMEs. This decision to highlight this focus is due to the significant contribution of the government in the financial inclusion process. Having central banks and financial regulators as advocates for financial inclusion makes sure that financial inclusion is among the top policy priority areas and ensures the presence of political will which would be trickled down to other market players (World Bank, 2014). Governments, more specifically central banks and financial regulatory authorities, are in

⁴ <https://www.ifc.org/wps/wcm/connect/156534804f860a72be27fe0098cb14b9/12316-vv-sme-report.pdf?MOD=AJPERES>

charge of the legal and regulatory environment, information infrastructure and can contribute directly with market development efforts (AFI, 2016).

The significance of this study arises from the importance of women's economic empowerment, which is one of the priorities on the Egyptian government's agenda as well as a focus area for non-governmental organizations (NGOs) and the international community (ILO, 2016). Women in Egypt are still struggling to assume their rightful role in the economy, therefore supporting them through developing an enabling business environment is of utmost importance (ibid). This is especially important to women in rural areas who face systemic impediments forcing them to stay within the boundaries of informal and very small businesses (ibid)

The study will address the gap in the literature on financial inclusion and women (Demirgüç-Kunt et al., 2013) and the little knowledge known about policies to foster financial inclusion (Allen et al., 2016) through its contribution to knowledge on financial inclusion and women-owned MSMEs in Egypt. This is done with the aim of finding ways by which policy makers, namely governmental organizations like central banks and regulators, can advance financial inclusion for women-owned MSMEs.

1.5 Research Objectives

The purpose of this study is to contribute to the growing knowledge on financial inclusion and women-owned MSMEs in Egypt. This is with the aim of establishing a conducive supporting environment that will advance women's financial inclusion, in which women can start and grow their businesses. This study aims to achieve its purpose through exploring barriers to women-owned MSMEs financial inclusion, current governmental interventions addressing these barriers

and the role that the relevant governmental entities play in policy-making and implementation to promote women-targeted financial policies. Based on the results of the analysis, possible recommendations can be inferred to promote financial inclusion of women-owned MSMEs.

1.6 Research Questions

The aim of this work is to explore barriers to the financial inclusion of women-owned MSMEs, current interventions conducted on the level of the CBE and Financial Regulatory Authority (FRA) in Egypt and how more women can be targeted. The main unit of analysis are women-owned MSMEs.

The study attempts to answer the following questions:

Main Research question: How can financial inclusion for women-owned MSMEs in Egypt be improved?

Sub research questions

- What are the constraints and barriers that hinder financial inclusion of women-owned MSMEs in Egypt?
- What are the current efforts undertaken by the central bank and, regulatory and supervisory authorities in Egypt to promote financial inclusion of women-owned MSMEs?
- How can the central bank, regulatory and supervisory authorities in Egypt integrate women into their current financial inclusion efforts?

1.7 Structure of the Thesis

The thesis is divided into six chapters covering the following domains

Chapter one introduces the topic, the rationale for conducting this work and the research objectives. A glimpse on the status of financial markets in Egypt along with information on MSMEs and women-owned MSMEs in Egypt.

Chapter Two offers a detailed review of the literature covering with respect to conceptualizing financial inclusion, barriers/constraints to expanded financial inclusion of MSMEs and role of the government in expanding financial inclusion of women-owned MSMEs

Chapter three presents the different theoretical concepts that guide the understanding in the study and how they are applied to financial inclusion of women-owned MSMEs in Egypt

Chapter four describes the research methodology conducted in the research. The chapter gives details about the research design, the overall research strategy, the sample selection, data collection and data analysis technique. Ethical considerations are elaborated and finally limitations and delimitations of the study are discussed

Chapter five presents a thorough analysis of primary data collected and is presented in alignment with the review of secondary data. Findings of the analysis are articulated in this chapter as well.

Chapter six concludes the main ideas that came across the study and offers some recommendations based on the weak points demonstrated in the analysis.

Chapter Two: Literature Review

The area of financial inclusion is mostly accompanied with questions around the different concepts of financial inclusion, which segments of the economy are excluded from the formal financial system, reasons for their exclusion and how can financial systems be more inclusive. The focus of this study is on conceptualizing financial inclusion of women-owned MSMEs within the wider literature. The literature is organized under three main thematic categories:

First thematic category focuses on conceptualizing of the term financial inclusion. It covers the emergence of financial inclusion as a concept and offers a range of definitions of financial inclusion highlighting the difference between access to and usage of finance.

Second thematic category tackles barriers or constraints impeding financial inclusion of women-owned MSMEs starting with barriers affecting MSMEs in general with a special focus on additional barriers affecting women-owned MSMEs. Barriers to financial inclusion are explored from the supply side, from the demand side and barriers in the enabling environment. For each of these subsections a detailed review is conducted.

Third thematic category highlights the role of the government through financial regulators and supervisory authorities in expanding financial inclusion for MSMEs with a trickle down to women-owned MSMEs. The role of the government pertaining to rules and regulations, financial market infrastructure and market development efforts are explored with each subsection thoroughly reviewed.

Analysis based on the review of literature is developed and the potential theoretical gap in this research area is highlighted at the final section of this chapter.

2.1 Conceptualizing Financial Inclusion

2.1.1 Financial Inclusion Definition

The definition of financial inclusion varies across regions because of variances in the social, economic and financial levels across the different countries (Kodan & Chhikara, 2013). That is the reason behind the absence of a universally accepted definition for the term financial inclusion (ibid; Lenka & Bariq, 2018). The concept of financial inclusion undergoes many changes, that is why academics and policy makers define it in ways that suit the objectives of their research (ibid).

To define financial inclusion, one needs to understand the concept of financial exclusion, this is because the term financial inclusion emerged to refer to people who are excluded from the financial market (Kodan & Chhikara, 2013). Similarly, Lenka and Bariq (2018) pointed out that financial inclusion is a tool to connect excluded people to the formal financial system, as it is a way of including the unbanked and the underbanked population into the banking fold. Financial inclusion allows the financially excluded population the opportunity to access institutional credit and other financial services, which can eventually lead to their empowerment, economic growth and social security (ibid).

Financial inclusion as a term caught much attention in the late 1990 in Britain, where socially excluded people were found to be financially excluded in research studies by Leyshon and Thrift (1993, 1994, 1995). A study by Leyshon and Thrift (1995, p. 314) offered one of the early definitions of financial exclusion as “those processes that serve to prevent certain social groups and individuals from gaining access to the financial systems”. The authors mainly focused on exclusion due to geographical access, when financial service providers have withdrawn their services from poor disadvantaged areas to focus on wealthier and more profitable client base

(Leyshon & Thrift, 1993,1994,1995). To cut costs, banks decided to focus on certain segments of the society, thus closing bank branches in areas where they do not generate enough profit and focusing on branches mainly open in large cities (ibid). This has led to a large strand of the population who have problems accessing basic financial services thus being financially excluded (ibid).

In the late 1990 studies by Kempson and Whyley (1999) as cited in Kim, Yu and Hassan (2018) focused on studying the financially excluded people in Britain and pointed out that a basic bank account is an important financial service to the low-income people. After that, studies on financial inclusion in the early 2000s mainly focused on introducing the basis of financial inclusion as a concept and described the characteristics of the financially excluded people (Kim et al, 2018). Beginning of the late 2000s, scholars have started to give more attention to measures of financial inclusion and relating financial inclusion to economic development (ibid).

Definitions and measurements of financial inclusion evolved to a more comprehensive nature viewing financial inclusion as a multidimensional concept rather than a dichotomous division as either included or not (Triki & Faye, 2013).

Some researchers including Lenka and Bariq (2018) focus on a certain strand of the population in their definition of financial inclusion as they define financial inclusion as a process to provide poor and low-income households with an array of financial services and products including credit, savings, insurance and mobile/internet banking at an affordable cost. Other researchers do not specify a target population in their definition, Sarma and Pais's (2010, p.613) definition is "Financial inclusion refers to a process that ensures the ease of access, availability and usage of the formal financial system for all members of an economy ". Kim, Yu and Hassan's (2018)

definition of financial inclusion follows in the same line referring to financial services and products being easily accessible and available to the whole population.

Some definitions of financial inclusion make the distinction between access to and use of financial services as Demirgüç-Kunt et al, (2008 p. 27) focus on use and define financial inclusion as “an absence of price or nonprice barriers in the use of financial services”. The authors then elaborate, that financial inclusion does not mean that all individuals are able to obtain unlimited amounts of financial services at an optimum price; this is because creditworthiness of the client remains the most important variable affecting price, amount and terms of financial services offered (ibid). Non-price barriers include design or features of a product, unavailability of financial institutions in certain areas, poorly developed regulations (World Bank, 2014). World Bank (2014, p. 15) in its global financial development report on financial inclusion, defines financial inclusion as “the proportion of individuals and firms that use financial services.” Allen, et al., (2016) definitions of financial inclusion highlights usage as they consider financial inclusion as the usage of formal financial services.

2.1.2 Difference between Access and Use

An understanding of the concept of financial inclusion requires a clear distinction between access to and use of financial services (Demirgüç-Kunt et al, 2008). Claessens (2006) elaborated on the difference between access to and use of financial services through using a demand-supply framework. Access focuses on the availability of supply of financial services at both reasonable cost and quality (ibid; Demirgüç-Kunt et al, 2008). On the other hand, use of financial services refer to whether individuals, households and firms are consuming those financial services. Using the demand-supply framework, access refers to the supply of financial services while usage refers

to the point of intersection between demand and supply curves. Claessens (2006) illustrates access and use through Figure one which categorizes people to three main groups according to use and access.

Group A:

Those who are currently using financial services, thus having both access and use

Group B:

Those who are choosing not to use financial services. Voluntarily excluded people as in they have access but do not consume financial services

Group C:

Those who do not use financial services due to lack of access. This is referred to as voluntary exclusion

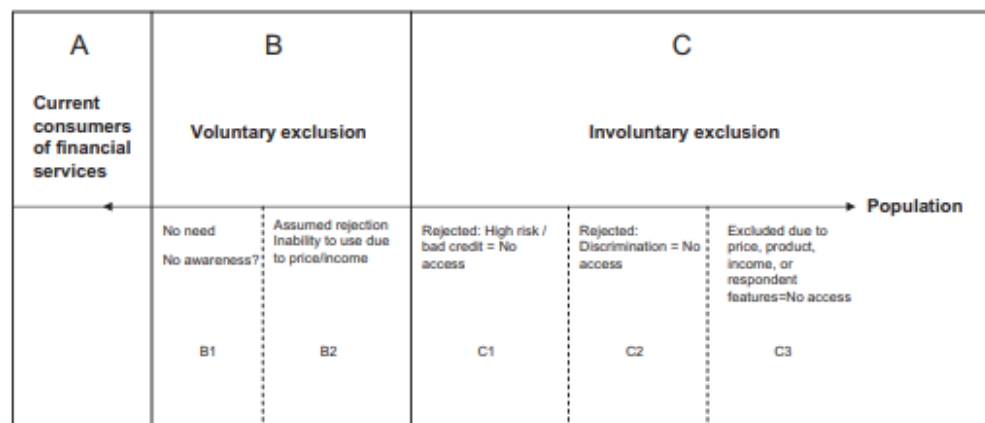


Figure 4: Difference between Access and Use

Source: Claessens (2006, p. 211)

2.2 Constraints and Barriers to Expanding financial inclusion for MSMEs

This thematic category in the literature highlights the different constraints and barriers to the financial inclusion of MSMEs briefly and highlights the constraints and barriers specifically faced by women-owned MSMEs.

Ayyagari, Demirgüç-Kunt and Maksimovic (2006) report that financing is one of the features of the business environment that was strongly linked to growth of firms. SMEs consider access to finance and cost of finance represent the most challenging feature in their business environment (Beck, 2007), more specifically small firms face greater obstacles than medium and large ones (Beck, Demirgüç-Kunt, Laeven and Maksimovic, 2004). Triki and Faye (2013) add that micro and small businesses and those businesses operating in the informal sector face a higher financing constraint. Women-owned enterprises are often highly challenged to access the appropriate types of finance allowing them to grow their businesses (ibid). Despite the role played by the growing number of microfinance institutions (MFIs) in reducing the financing gap for micro and small enterprises, MFIs are still unable to meet long-term growth financing needs as they offer short-term high cost credit and are constrained due to limited funds (ibid).

IFC (2010) reports on the non-financial barriers faced by SMEs in accessing finance. Prior to examining financial barriers, it is critical to look into the non-financial barriers which can also impact and are overarching over the whole economy(ibid). The five factors which were frequently reported by SMEs as their non-financial barriers are lack of electricity, increased taxes, practices of competitors in the informal market, heavy rules and regulations and corruption (ibid). The focus of this study will only be on financial barriers affecting the supply and demand of financial services

by MSMEs. Financial barriers include deficiencies in the enabling environment and weak financial institutions capabilities and delivery mechanisms (ibid). The enabling environment include two dimensions the overall legal and regulatory framework for the financial market and financial market infrastructure (ibid).

IFC (2010) reports that the gap in SME financing is due to a mismatch between needs of SMEs in the form of their demand and the supply of financial services by financial institutions. Supply refers to the array of financial services available in the market for MSMEs, services range from savings and credit to payments and insurance. For factors ranging from high risk of default, limited collaterals and lack of solvency information, MSMEs face barriers accessing formal finance, which is the main reason of their dependency on other sources of funding for financing their growth (Triki & Faye, 2013). Businesses mainly use informal sources of finances during their early stage, as businesses grow and expand they become more in need of external sources of finance (IFC, 2010)

Some studies pointed to the existence of a gender gap in financial inclusion, a study by Saviano et al., (2017) addressing the financial gap for women in the MENA region shows that women's opportunities to receive financial support to start and grow their businesses is less than that of men. According to cross-country studies, women were found to receive a lower percentage of external financing for business use as opposed to men, however, evidence suggests that this is due to deficiencies in the business environment rather than explicit discrimination against women (Klapper and Parker, 2011). These deficiencies in the external business environment envisages women to be perceived as a higher credit risk (ibid). According to a report by Making Finance Work for Africa (MFW4A, 2012) women in general are challenged with constraints when entering the formal financial system, the constraints are both particular to the financial sector and

overarching across the society. This thesis will only focus on constraints related to the financial sector.

2.2.1- Supply-Side Barriers

As pointed out earlier, access refers to the supply of financial services (Claessens, 2006). Supply-side barriers refer to constraints affecting the access to financial services (Demirgüç-Kunt et al, 2008). Lack of access to finance include problems in the availability and cost of the finance (World Bank, 2014). Supply side barriers are presented below first for microbusinesses then for SMEs. Barriers for SMEs include financial market imperfections, complex application procedures, and poor financial institutions' capabilities and delivery models,

A- Access barriers for Microbusinesses

The World Bank (2014) in its report on financial inclusion distinguishes between microenterprises and small and medium in its examination of challenges to businesses' financial inclusion. This report uses the number of employees as a basis for the definition of MSMEs⁵. Their rationale is that financing needs differ from micro enterprises to small and medium ones. Microenterprises financing needs are often supplied through MFIs as they require smaller amount of loans, while small and medium firms financing needs are usually met through banks and other financial institutions like leasing and factoring firms (ibid).

High operational costs of giving out loan to microcredit, lack of sufficient collateral and inadequate documentation using formal accounts are the three main reasons behind commercial banks limited credit to microenterprises as highlighted by the World Bank (2014). Banks usually require some

⁵ Microenterprises, defined here as firms with fewer than 5 employees, and SMEs, defined as firms with 5–99 employees

form of collateral to give out credit, which is a requirement unmet by microenterprises due to their limited resources (ibid). Moreover, banks are unable to collect information about microenterprises due to their limited use of formal financial documents, which makes them an opaque segment to banks (ibid). Pearce (n.d) in a report analyzing financial inclusion in the MENA region states that, wholesale financing to MFIs is the indirect channel between banks and microenterprises. MFIs, unlike banks, are better equipped to serve microenterprises as they are closer to the clients and customize their lending techniques and delivery channels to the needs of that segment (ibid).

An important access barrier faced by microbusinesses is the shortage in appropriate products and services that meet their needs (Demirgüç-Kunt et al., 2008). Microloans are not always the best financial instrument for investment and growth of microenterprises mainly because of repayment procedures and joint liability (World Bank, 2014). This is because most repayment schemes of microloans oblige loan takers to start paying back immediately after taking the loans which does not promote investment and growth (ibid). Moreover, microloans are given to a group of lenders-microenterprises, which discourages microenterprises from making a risky investment because other lenders might end up paying more if the investment was not successful (ibid).

B- Small and Medium Enterprises Supply-Side Barriers

➤ Financial Market Imperfections

Literature studying impediments to financial inclusion, report that financial market imperfections or market frictions such as transaction costs and information asymmetries are among of the factors challenging expanded financial access for MSMEs (Beck and De La Torre, 2007; Beck, 2007; Demirgüç-Kunt et al., 2008). Transaction costs and information asymmetries are the main drivers behind different levels of access to finance for businesses with varying sizes (ibid). Transaction costs include costs for credit assessment, processing, and monitoring which are fixed costs

independent of the loan amount, which means that as the loan amount increases unit costs decrease (ibid). Transaction costs can be a constraint to all borrowers, however, some might argue that they represent a higher constraining factor for small and medium enterprises (ibid). This is because SMEs have diverse features and are relatively opaque, which results in higher assessment and monitoring costs incurred by financial institutions (ibid).

Default risk related to borrower-specific risks are one of the constraints to SMEs financing, more particularly barriers related to asymmetric information between the borrower and the lender. If the borrower does not share enough information about his/her project, and the lender institutions can only get this information with incurring high costs then this leads to two different risk sources, adverse selection and moral hazard (Beck and De La Torre; Beck, 2007). Adverse selection occurs before rendering credit to the borrower, which refers financial institutions facing difficulties in selecting good credit risks. Moral hazards occur after giving credit to the borrower, referring to the lender being unable to enforce the agreed conditions of the credit contract (ibid). High transaction costs and greater risks involved due to information asymmetries often lead to a higher finance fees for SMEs compared to larger firms more specifically in developing countries (Beck, Demirgüç-Kunt, and Maria Soledad, 2008).

Buvinic and Berger (1990) argue that MSMEs financial inclusion for women is disproportionately constrained due to formal financial institutions facing information asymmetry related to women's MSMEs. Information asymmetry for female entrepreneurs is due to limited engagement between female entrepreneurs and formal institutions such as through employment. Such prior relationships with formal institutions are useful for women because they leave an audit trail of information that could be tracked by formal financial institutions to offer services. Lack of this information track for women could lead to exclusion from the formal financial market (Kairiza et al., 2016) and

could also lead to women-owned companies paying higher interest rates than those owned by men as shown by Coleman (2000) on her study for small service firms in the United States.

➤ **Complex Application Procedures**

Banks usually require firms to provide a proof for financial performance in their application forms. SMEs have reported difficulty in filling application forms because SMEs especially informal ones have difficulty in providing solid financial record that can document the firm's financial status (World Bank, 2014). As reported by IFC (2010), small firms more specifically may find it difficult to provide for their financial performance because they have insufficient credit history. Furthermore, SMEs have low levels of financial literacy, which could make it difficult for SMEs to assess and comprehend the different array of financing options available and could also affect SMEs' ability to navigate through complex loan application and procedures (ibid).

As reported by AFI and Women's World Banking (WWB, 2016) complex application and procedures is a more constraining barrier for women-owned MSMEs as women have lower levels of financial literacy. Females were found to have weaker loan applications relative to men as females found completing loan applications difficult (Buvinic & Berger 1990). SMEs led by women face challenges in presenting solid application forms to credit officers and lack capabilities to stand by their business proposal (Lusardi & Turano, 2009).

➤ **Financial Institutions Capabilities and Delivery models**

Barriers related to deficiencies in the enabling environment for financial services can be reduced through the use of internal lending technologies which decrease information asymmetries such as the relationship lending model (IFC, 2010). Relationship lending "relies on personal interaction between borrower and lender and is based on an understanding of the borrower's business and not just on collateral or mechanical credit scoring systems" (Demirgüç-Kunt, 2008, p. 9). Relationship

lending is considered costly for financial institutions, which requires lenders to charge high interest rates or engage in large volume. However, if the customer creditworthiness proved difficult to evaluate, then financial institutions will have no option except relationship lending. Due to high costs of relationship lending and high-volume requirements, financial institutions might be reluctant to use it (Demirgüç-Kunt, 2008; World Bank, 2014). This is specifically true for SMEs, as relationship lending incurs high internal transaction costs which limits the financial institution ability to reach SMEs at cost-effective rate (IFC, 2010). Capabilities of the financial institutions affect their outreach to SMEs. For example, leasing companies cannot develop when they face challenges in repossessing the leased asset and disposal of the asset, banks could be discouraged in its application of project finance especially with SMEs because banks have shortages in technical assessment of perceived risk. Cost of the distribution and outreach of SMEs could also be a factor contributing to the SME finance gap (ibid)

Delivery models of banks and other financial institutions have been reported as barriers for women-owned businesses. A study by AFI and WWB (2016) reports that service delivery of financial institutions does not adapt to women's needs, as women feel that bank facilities are not a welcoming environment, which made women feel uncomfortable. Banks also does not take women's conditions into consideration as they have limited working hours. This is also supported by (IFC & GPFI, 2011) which states that that banks are not adapting their operations to be fitting women's needs for example opening hours or the availability of banks 'outlets. Due to culture and norms, women entrepreneurs face greater challenges in their mobility and face higher demands on their time (ibid). A MFW4A (2012) report on challenges faced by Africa women reported that delivery mechanisms of banks do not adapt to women's needs especially low-income women as banks did not design their branches to be an environment which attracts women. Banks limited

physical outreach and business hours do not women's challenges on mobility into consideration (ibid).

2.2.2 Demand-side Barriers

➤ Limited Financial Capability and Financial literacy

Financial literacy as defined by the Organization for Economic Cooperation and Development and International Network on Financial Education (OECD/INFE, 2013 p. 12) is “A combination of awareness, knowledge, skill, attitude and behavior necessary to make sound financial decisions and ultimately achieve individual financial wellbeing”. To shed more light on the behavioral component of financial literacy rather than financial knowledge, the term “financial capability” came into place to extend the concept beyond the idea of financial literacy.

Gradstein, Randall and Ardic Alper (2018 p. 26) defines financial capability as the “principal knowledge, skills, attitude, and behavioral constraints to greater uptake and usage of appropriate financial services by individuals and MSMEs “. Financial capability includes a range of concepts including being financially knowledgeable, skillful and capable (World Bank, 2014). Financial knowledge refers to knowing the array of financial products available, financial institutions and financial concepts (ibid). Being financially skillful, refers to having financial skills such as being able to calculate compound interest rates and payments “(ibid). Financial capability which is the much wider concept includes knowledge, skills and behaviors enabling individuals and businesses to use financial services to their best interest (ibid)

According to IFC (2010), SMEs might have financial literacy challenges which can affect SMEs ability to assess, understand the different financing options available, affecting the quality of financial statements available to financial service providers thus increasing the perceived risk of

SMEs. Low levels of financial literacy can also prevent SMEs from adequately filling and navigating complex application forms.

According to a study by AFI and WWB (2016), lack of financial literacy and awareness were cited consistently as one of the main barriers to the access and use of financial services by women-owned businesses. According to surveys conducted by OECD/INFE (2013), women in many countries have lower financial knowledge as compared to men and have less confidence in their financial knowledge and ability to handle complex financial issues(ibid). Women are vulnerable when it comes to their financial behavior for example women face more difficulties in selecting financial products that fit their needs (ibid). This information was further supported by a policy brief prepared by MFW4A (2012) on financial inclusion of African women, which reported that women had low levels of financial capability and self-confidence when managing their finances and especially when dealing with formal financial institutions. Women were underserved or an unserved segment of the market and are considered new to the financial system which makes them disadvantaged and unable to seize opportunities without exposing themselves to risk (ibid). This risk is due to women lacking or having little experience of using financial products and services which also limits their capabilities in choosing financial options which best suits their needs (ibid)

➤ **Lack of Assets for Collateral**

Due to inability of SMEs to provide enough information on their financial performance, financial institutions especially banks usually demand collateral requirements as a form of security (World Bank, 2014). Fleisig, Safavian, and De la Peña (2006) reported that some businesses especially SMEs did not even try to apply for loan because they believed that they could provide collateral requirements requested by banks

When women do not turn to informal sources of finance, they seek debt financing through external sources which requires provision of collateral (OECD, 2011). As pointed out by Buvinic and Berger (1990), women had lower ability in providing collateral. This point was reinforced by Coleman (2000) who reported that women with small business face constraints in accessing finance because of lack of collateral and lack of personal guarantees (Coleman, 2002). Women face difficulties in providing immovable collateral due to discrimination against women in land and property rights and because of culture norms (AFI & WWB, 2016)

2.2.3 Legal and Regulatory Constraints

Legal and regulatory constraints are any relevant laws, regulations or provisions (or the lack of laws, regulations or provisions) that affect the inclusiveness of MSMEs in the financial market or affect the ability of financial service providers to supply services to MSMEs (World Bank, 2014)

A report by IFC (2011) on least developed countries states that one of the largest challenges faced is the poor capacity of the regulatory and supervisory authorities. These authorities might face challenges doing their main regulatory and supervisory tasks due to lack of adequate human and financial resources (ibid). This makes performing additional tasks related to monitoring of SME finance or the potential coverage of microfinance institutions and non-bank financial services difficult (ibid).

Advancing access to finance for SMEs does not entirely depend on the banking system but could also be achieved through increasing access to a wide array of non-bank financial services (IFC, 2011). Non-banking financial institutions provide a range of services to SMEs such as financial leasing of machine or equipment, factoring or purchasing of account receivables at a discounted rate. Factoring provides an important source of working capital finance for SMEs and leasing

represent a source of investment finance for SMEs, especially true in countries when financial infrastructure is poor (ibid). Factoring and leasing are important specifically for SMEs because it addresses the problem of SMEs' opaqueness, as factoring and leasing do not focus on credit worthiness or the ability of SMEs to provide collaterals. Instead factoring depends on the quality of the obligor and leasing focus on the firm's ability to generate cash to make the leasing payment (ibid). Despite the importance of non-banking financial services to SME financing, in some countries leasing and factoring companies face obstacles due to undeveloped rules and regulations governing leasing and factoring transactions or an unclear taxing rules (IFC, 2010, 2011)

Though there might not be explicit laws discriminating against women's financial inclusion, some laws and regulations might weaken the ability of female to do business as opposed to men. According to the World Bank and IFC (2012) report on women's business and law, there is at least one legal difference between men and women that may impede women's economic opportunities. Family law in many countries enforce barriers on women in their ability to sign contract and own assets in their names which might affect women's ability to use property as collateral for lending (ibid). In all countries, married women face the same or more differentiations than unmarried women. However, this loss in rights associated with marriage only happens for women and not men. In a later study by Demircuc-Kunt, et al., (2013) researchers tried to explain the gender gap in financial inclusion by exploring the degree of economy-wide legal discrimination against women. Women have less ability than men in owning, managing, controlling assets and property due to differential treatment of women under the law or by customs. These differences might influence women's access to and demand for financial services (ibid). Women were also found to be less likely than men to engage in financial transactions like owning an account, saving and borrowing in countries where women face legal discrimination in areas related to ability to work,

heading a household, choosing where to live, inheriting property or when they are required by law to obey their husband (ibid).

2.2.4 Financial Market Infrastructure Deficiencies

Financial market infrastructure establishes the foundations for financial intermediation as it includes framework for information, contracts and transactions (IFC, 2010). Financial market infrastructures act to decrease financial market imperfections. Barriers to financial inclusion includes weaknesses in the financial market infrastructures dealing with financial market frictions (Demirgüç-Kunt et al., 2008). Financial market infrastructure limitations include lack of secured transaction framework, lack of an effective insolvency regimes and lack of an effective credit information framework (IFC, 2011).

➤ Lack of a secured transaction framework

Due to asymmetric information, only borrowers know their current financial statues and their true conditions, however, lenders have to guess (Fleisig et al., 2006). Collaterals reduce risks associated with asymmetric information, as when lenders acquire information about the collateral, it can act as a substitute to lack of information on the borrower (ibid). Collaterals are considered an insurance tool against uninsurable risk or international default by the borrower, because lenders could sell collateral and substitute for the defaulted loan. Secured transactions are “transactions in which the parties agree to secure an obligation with an enforceable security interest in property” (ibid, p. ix). Collateral frameworks are an indispensable part of credit financial system. Collateral frameworks can help in the reduction of moral hazard and adverse selection thus enhancing SME financing by decreasing the risk and losses of lending institutions (IFC, 2011). Through an effective secured

transaction framework, movable assets could be used as collaterals for lending, which is specifically important for SMEs as SMEs are in possession of more movable than immovable assets (ibid).

IFC (2011) argues that the main challenges facing a secured transaction framework lies in the lack of a secured lending legal and regulatory framework, poor capacities to maintain a collateral registry system, reluctance of financial institutions to accept movable assets as collaterals, and weak judicial systems challenging the enforcement of security interest. Fleisig et al., (2006) argue that in countries who did not reform the secured transactions law and regulations, most of the assets that firms have cannot be used as collaterals for loans, rendering these assets to be become dead capital. Unreformed legal systems are the reasons for limited access to finance as companies own a wide array of assets, but laws and regulations limit the use of these assets such as movable assets, which leads to limited access to credit, higher interest rates and reduced volume of loans (ibid)

➤ **Lack of an Effective Insolvency Regime**

Bankruptcy or an insolvency regime deals with creditor rights which affect access to finance, as stronger creditor rights enhance access to finance (World Bank, 2014). Bankruptcy regimes regulate the efficient exiting of the market, and make the resolution of multiple creditors' conflicting claims more orderly, resulting in more extensive opportunities for recovery (ibid, p. 125)

Insolvency frameworks might suffer from legal gaps which makes them unable to deal with SMEs effectively (IFC, 2010). SMEs can be categorized into two broad categories, corporate SMEs and non-corporates, the main difference between them is the extent of the legal liability (ibid). The limit of the legal liability of the shareholders of corporate SMEs is the amount of their capital

contribution to the business (ibid). On the other hand, in non-corporate SMEs, there is no distinction between the legal identity of the business and the legal identity of its shareholders, which makes the debts of the business the debts of the owners (ibid). Insolvency reform took place in some countries through establishing a unified insolvency act that deals with all legal forms, however most countries did not undertake this type of reform and kept insolvency provisions under the companies act (ibid). The problem is that most legal systems dealing with SMEs either have an outdated insolvency law or have a modern insolvency framework, in which insolvency law is contained under the companies act (ibid). Companies act either has no application on non-corporates or includes outdated or no personal insolvency provisions (ibid).

World Bank (2014) argues that an absent legal insolvency framework can negatively affect SMEs through the following:

- First SMEs have no safety nets if they face short-term liquidity problem, as SMEs who are facing financial problems cannot pursue temporary protection from its creditors nor can it propose a plan to organize payment or compromise debt for the attainment of higher returns for creditors
- Second, if SMEs are liquidated, SMEs will face challenges in navigating an orderly and transparent way for the repayment of creditors and the return of productive assets into the economy in a timely fashion

➤ **Lack of an Effective Credit Information Framework**

The availability of reliable and good quality information is extremely important in the functioning of financial systems as it assists with the reduction of information asymmetries between borrowers and lenders (Demirgüç-Kunt, 2008). Challenges related to credit information framework are summarized in the following points by World Bank (2014):

- Lack of an adequate legal framework that protects the right of consumers, manage privacy because personal credit information is widely available, and ensure a transparent and equitable information sharing environment for all market players
- Existing credit information systems cover banks only, with lack of coverage on other nonbank financial institutions and microfinance
- Reluctance from the side of established lenders to share credit information about their clients, because they benefit from exclusive access to this kind of information against their competitors

2.3 Role of the Government in Expanding Financial Inclusion for MSMEs

Addressing policy and market failures that lead to financial exclusion are critical to the development of inclusive financial systems. In order to do this public-sector's main role lies in the development of appropriate legal and regulatory structures, supporting the information environment and working on the education and protection of the users of financial services (World Bank, 2014). Beck and De la Torre (2007), elaborates that the role of governmental policies is building financial infrastructures which allows financial service providers to supply their services as widely as possible without being hindered by rules, regulations or failures in coordination mechanisms. There are various factors including available resources, needs of MSMEs, and level of country's financial sector development which influence the choice and implementation of different governmental policies targeted at promoting MSMEs finance (AFI, 2016)

The literature addressing the role of government in MSME financial inclusion mentions three main areas which are building a supportive legal and regulatory framework, maintaining an enabling financial market infrastructures and market development interventions (IFC, 2010; IFC, 2011; World Bank, 2014; AFI, 2016). These areas will be discussed hereunder in more details. A report

by the IFC (2011) categorizes SME finance policies by governments and regulators according to their time frame, as in the medium term an enabling regulatory framework and financial infrastructure are of essence to promote significant advancement in access to finance for SMEs. However direct public intervention may be needed on the short term to act as compensation for the deficiencies in the enabling environment until medium-term and long-term reforms are being implemented (ibid). According to the availability of financial inclusion data, governments prioritize and select the appropriate policy intervention (ibid).

IFC (2011) reports that governments and financial regulators should champion the efforts for increasing access to finance through placing financial inclusion as a policy priority. Countries in which financial regulators work on financial inclusion strategies put more focus and assign more resources and staff to work on it. A national financial inclusion strategy (NFIS) represent a road map of agreed upon actions that stakeholders adhere to for advancing financial inclusion (World Bank, 2012).

2.3.1 Legal and Regulatory Framework for MSMEs

The legal and regulatory framework is defined by IFC (2010, p. 28) to include “the collection of laws and regulations that define the scope and depth of all the financial institutions, instruments, and markets operating in a given country”. Ensuring an efficient regulatory and supervisory environment is the primary role of regulators, in particular to the financial system which cannot function without a range of comprehensive legal and regulatory framework that puts in place accounting, auditing, legal and judiciary rules and regulations, in addition to requirements for specific sectors which are prudential regulations (IFC, 2011)

A supportive legal and regulatory framework for MSME finance is one of the areas by which the government can promote financial inclusion (World Bank, 2014; AFI, 2016). Regulatory and

supervisory authorities have significant contribution in designing and implementing an enabling environment for the development of SME finance (IFC, 2011). This includes developing a legal and regulatory framework that can enhance access to finance, developing interventions with the aim of promoting SME finance and collecting and analyzing financial inclusion data (ibid)

Legal and regulatory framework is of heightened importance to SME finance, as for example regulations enforcing the entry of credible and efficient banks enables competition in the financial market resulting in the reduction of profits from traditional business lines and encouraging banks to develop SME banking products (IFC, 2010). Property rights laws and effective enforcement of contracts are indispensable parts of a supportive regulatory environment as the ability of companies to raise external finance is negatively affected if the rights of outside investors are not effectively protected (Demirgüç-Kunt, 2008). In the meantime, outside investors will not be encouraged to make investments if they will not be able to exert corporate governance and protect their investment from the control of the owners of the company (ibid). A study by Beck, Demirgüç-Kunt, & Maksimovic (2005) reports that countries where legal enforcement is strong, companies are able to access external finance. Another study by Beck, Demirgüç-Kunt, & Levine (2004) report that financial systems are more efficient and have lower interest rate spreads in countries with effective legal systems (Demirguc-Kunt, Laeven and Levine, 2004).

Regulators work on developing sector-specific requirements, as an example for this are prudential regulation and lending guidelines for SMEs (AFI, 2016). Financial regulators can also issue guidelines with the aim of encouraging financial institutions to lend to SMEs through reducing risk weights associated with SME credit and reducing liquidity requirements. Improving the credit processes for SME lending and enforcing a specific quota for SMEs credit are other types of regulations used by regulators to spur SME finance (ibid).

An important role of regulators is establishing a regulatory framework including legislation, taxation and other rules for alternative sources of financing for SMEs like leasing and factoring which suit the needs of small and medium enterprises (Demirgüç-Kunt et al., 2008; IFC, 2010; IFC, 2011). The policy and regulatory framework should be an enabler rather than an inhibitor of innovative financial services, but at the same time mitigating risks of specific types of services. A proper design and implementation of regulations helps financial markets to operate as intended (IFC, 2011). High quality regulations are both effective and efficient, referring to regulations reaching its desired objectives at the lowest possible cost (ibid)

AFI (2016) reported that there are various parties involved in the country's overall strategy for supporting MSMEs, SME specific laws and regulations define the different roles and responsibilities of each party clearly. Regulators are in charge of issuing laws specifically for SMEs act to enhance and support the growth of SMEs in all sectors of the economy (ibid). These laws categorize and define SMEs according to their size into micro, small, or medium. Having a concrete, unified definition for SMEs have several benefits as it provide a common national understanding and allows policies to be targeted at specific sectors. In addition to that having a unified definition of MSMEs facilitate the development of technical assistance programs, enables funds to be delivered effectively and helps the establishment of databases for MSMEs through collecting comparable data (ibid; IFC, 2011)

2.3.2 Financial Market Infrastructure

An enabling financial infrastructure helps in reducing risk to lenders and expanding supply of credit facilities, through reducing risks related to information asymmetries and legal uncertainties (IFC, 2010). The development of a country's financial infrastructure expands access for all firms, but SMEs acquire more benefits, as problems related to information asymmetries and opaqueness

are severe for smaller companies (ibid). Financial market infrastructure can be defined as including “accounting and auditing standards, credit reporting systems (credit registries and bureaus), collateral and insolvency regimes, and payments and settlement system “(ibid, 2010 p. 29).

➤ **Accounting and Auditing Standards**

Financial supervisory authorities enforce certain accounting and auditing standards which could improve SME access to finance (IFC, 2010). This is because strong accounting and auditing standards reduces opacity of information associated with SMEs and in the same time encourage financial statement-based lending (ibid). On the other hand, accounting and auditing standards can impose a burden on SMEs, that’s why countries should work on balancing improving transparency and the reduction of regulatory burden on SMEs (ibid). Some studies like Levine, Beck and Loayza (2000) argue that there is positive association between effective accounting standards and some measures of access to finance. However, research in this area, were not focusing on SMEs and has been underscored by lacking good quantitative indicators on the quality of financial reporting (IFC, 2010)

➤ **Credit Information and Credit Bureaus for SMEs**

Evidence from a World Bank report (2014) shows that governments play an important role in management of the information environment. Developing information infrastructure in the form of credit reporting systems is critical to financial depth and access (Demirgüç-Kunt et al., 2008). Policy makers can have a large effect on financial inclusion through reforming credit bureaus (World Bank, 2014)

Credit reporting system includes Public Credit Registries (PCR) and Private Credit Bureaus (PCB), which assumes critical functions in the financial system supporting both supervisors and lenders (IFC, 2011). Credit information systems support banking supervision as supervisors use it for the

prediction of the performance of bank portfolios. Lenders also benefit from credit information systems through screening of potential customers and predicting their loan repayment behavior (ibid)

Governments can play an important role in developing the information infrastructure through establishing PCR (Demirgüç-Kunt, 2008). PCR is mainly established for the purpose of offsite supervision, PCR is a database collected by the central bank or other financial regulatory authority which includes information from banks and other regulated financial institutions (IFC, 2011). The main advantage of a PCR is that since its managed by the government, it has the power to oblige banks to share information. However, since PCR's main purpose is for supervision, the collected information is mostly from regulated banking sector, this makes the collected data limited in scope and coverage (ibid), which encouraged private entry through PCR to provide more services as argued by Demirgüç-Kunt (2008). This point was further supported by Demirgüç-Kunt et al., (2008) stating that PCRs are often complemented with PCBs.

PCB is private organization which works on collecting data from a wide range of financial institutions then it works on distributing it back to their subscribed members through a common-information sharing network (IFC, 2011). Lenders like banks and other financial institutions provide PCBs with information about their customers, referring to the details of the loan, and its repayment scheme (ibid). This information is provided on a voluntary basis, reciprocity included. PCBs cover a wider range of the financial market and also provide more services to its members like credit scoring solutions (ibid)

Empirical evidence suggests that countries supporting more information sharing have higher volumes of bank credit (Jappelli & Pagano, 2002). Djankov, McLiesh, and Shleifer (2007) reports on the association between the establishment of private or public credit registries and a higher ratio

of private credit depth to GDP. Smaller companies report less credit obstacles in countries where credit information is available via credit bureau (ibid). Moreover, a study by Love and Mylenko (2003) on 5,000 companies in 51 countries study shows that firms report less credit constraints with the availability of more credit information.

Credit reporting systems are critical to SMEs' access to credit, through providing lenders with accurate and credible credit information which indicates whether the probability of loan repayment by a potential customer (IFC, 2010, 2011). This information decreases the risk of lending and the associated cost of loan default (ibid). Well-functioning credit information systems helps in decreasing adverse selection and moral hazard especially for SMEs which suffer from opacity of information (ibid). The role of the government is critical especially in developing countries where the existence of credit registries and bureaus seems to be more important.

➤ **Effective Secured Transaction System and Insolvency Regime**

As elaborated above one of the barriers to access to finance was a lack of secured transaction framework, government's role lies in increasing access to credit through reforming the secured transaction laws and registries (WBG, 2010). Government role in promoting a secured transaction framework, lies in raising awareness about the importance a secured collateral framework, establishing of supporting laws and regulations, developing modern collateral registries, establishing enforcement mechanism that does not involve court orders, and capacity building for enforcement officers and judges on alternative enforcement tools for security interests (IFC, 2010)

Well-functioning secured transaction system, increase the level of credit used by firms and decrease the cost of credit. This is particularly useful for SMEs, as countries that have a stronger secured transaction laws and registries have expanded access to credit, lower cost of credit, higher ratings of financial systems stability and reduced rates of non-performing loans (WBG, 2010).

Fleisig et al., 2006 argue that the role of policy makers and regulators lies in reforming the legal framework for secured transactions, including issuing a new law which governs the use of movable assets as collateral and developing a movable assets registry which is a modern filing archive designed to publicize the claims against such property. A secured transaction legal framework controls the way by which a security interest is created, who can create it, which entity has the priority in the receipt of funds from sale of the collateral, the way security interests are made public, rights of other parties in the collateralized property, the way property is repossessed in the event of default, how it will be sold and how the funds of the sold property be used to satisfy the claim of the party who owns the security interest (ibid).

Secured transaction reform can lead to an increase of access to credit for women, specifically women entrepreneurs (WBG, 2010). A secured transaction reform which allows the use of movable assets such tools, machinery, debts, jeweler as collaterals would benefit all businesses (ibid). However, potentially it could lead to a greater benefit for women who lack access to land in a number of countries as it allows them to use the assets in their possession to enter the formal financial system (ibid).

Insolvency regimes are a critical aspect of the financial infrastructure affecting SMEs access to finance through supporting predictability in credit markets. The government should develop an effective insolvency framework regulating the efficient exits of firms from the market, allowing resolution of debts incurred by debtors in financial distress to be through an orderly way that promotes fair treatment, and giving bankrupt entities and their creditors the opportunity to recover (Cirmizi,Klapper, and Uttamchandani 2012) The government should also work on establishing a modern framework for SME insolvency which starts with legislations that expedite bankruptcy

procedures for SMEs, introducing frameworks for alternative dispute resolution such as mediation (IFC, 2010).

2.3.3 Policy and Market Development Initiatives

Governments plays a critical role in the support and the regulation of financial services provision, this is to address market failures due to information gaps and establish a coordination mechanism for collective action for financial sector development (Demirgüç-Kunt et al., 2008). Market development initiatives mainly relates to capacity building and training and financial capability and consumer protection (IFC, 2010; IFC, 2011; AFI, 2016)

➤ Capacity Building and Training

According to IFC (2010) capacity building efforts targeted at financial institutions is critical to achieving objectives of expanded financial access and use. This is because it assists financial institutions with accessing new markets or new segments, and with offering more products or services (ibid). Capacity building and training relevant to SME finance includes methods to segment the SME market, how to streamline the SME credit process (ibid).

IFC & GPFI (2011) report that capacity building and training could be targeted at women-owned MSMEs. This is through building training programs which introduces specific needs of women and challenges they face (ibid). This could be particularly useful for financial services provider to integrate women into their product design strategy, outreach strategy and marketing materials (ibid)

➤ Financial Capability and Consumer protection

Consumer protection aims to level the playing field between financial service providers and consumers of financial services. Financial institutions usually have more information about the

financial transaction than their retail customers which can lead to customers paying excessively high interest rates, shortages in understanding of financial tools available and insufficient ways for redress. This inequality of information is higher when the customers have less experience and products are more complicated (AFI, 2010) It is importance that new customers of the financial market as well as existing ones with access to new services have the ability to make well-informed decisions on ways to manage and use financial services. Moreover, the entry of new providers and delivery mechanisms increase the probability of consumer fraud and abuse, therefore it is critical to establish consumer protection frameworks (World Bank, 2012)

AFI (2010) argues that there is an informational imbalance between consumers and financial institutions, as consumers have less information and sophistication. As a result of this regulators should put in place appropriate regulations and rules to make up for the imbalance and encourage financial institutions to apportion information disclosure at different times. Relevant information concerning financial services should be disclosed before entering the financial contract, during it and after the end of the contract (AFI, 2010). A report by the World Bank (2012) is in agreement with AFI (2010) stating that financial consumer protection rules should make sure that:

- consumers receive accurate and comprehensive information to be able to make informed decisions
- consumers are not unfairly treated or being deceived by financial institutions
- consumers have access to dispute resolution mechanisms

Consumer protection rules coupled with enhancing consumers' financial capability will increase consumers' trust in financial markets (World Bank, 2012). As indicated earlier, low financial literacy is among the barriers constraining MSME's financial inclusion (IFC, 2010). AFI (2016)

argues that financial education and awareness is part of the regulator's role to increase access for finance for MSMEs. Regulators should develop the following two areas:

- raise awareness of MSMEs about the different financial services available in the market
- prepare MSMEs through knowledge on financial management which could make MSMEs more attractive to banks

According to OECD/INFE (2015) financial inclusion policies that only targets supply-side factors cannot pledge an effective and increased usage of financial services. Therefore, policy makers are using financial education policies as a tool to assist in addressing the above-mentioned barriers (ibid). Financial education could improve financial literacy through enhancing financial knowledge skills, and behaviors. Financial education efforts could be considered complementary to financial inclusion and consumer protection efforts, which could help raise trust and confidence in financial markets (ibid). According to OECD (2005 p. 12) financial education can be defined as “The process by which financial consumers/investors improve their understanding of financial products, concepts and risks and, through information, instruction and/or objective advice, develop the skills and confidence to become more aware of financial risks and opportunities, to make informed choices, to know where to go for help, and to take other effective actions to improve their financial well-being”

Financial education can contribute to the reduction of demand-side barriers through raising financial awareness and addressing psychological barriers (OECD/INFE, 2015). When financial literacy is improved, awareness and understanding of financial products and services are enhanced, this would promote demand for financial products and enhance their effective use (ibid). That is why policy makers policy makers are working on developing financial education strategies

coupled with consumer protection frameworks which should be targeted to the relevant segments along with a supply of demand-driven financial products (ibid)

Conclusion

Despite the vast literature on financial inclusion, MSME finance, and women's financial inclusion, there is an evident gap in addressing the role of the government in promoting financial inclusion of women-owned MSMEs. Most of the literature focusing on women's financial inclusion address it from a household perspective, and not for a business perspective. In addition, most of the literature addresses access to finance, without taking into consideration other dimensions of financial inclusion like usage and quality. Furthermore, there is a gap in literature addressing financial inclusion in Egypt, especially financial inclusion of women-owned MSMEs. Literature in that regard do not provide ample answers to the question of how financial inclusion of women-owned MSMEs can be expanded. This thesis attempts to address this gap through an exploratory study on financial inclusion of women-owned MSMEs in Egypt, challenges to expanded financial inclusion and current efforts to promote financial inclusion.

Chapter Three: Conceptual Framework

3.1 Theoretical Concepts

This study attempts to explore the process of financial inclusion in Egypt as relates to MSMEs, more specifically women-owned MSMEs. This is through exploring dimensions of financial inclusion, barriers impeding women-owned MSMEs expanded financial inclusions, on-going efforts by the government especially financial regulatory and supervisory authorities to address these barriers and promote inclusive financial systems.

There are various approaches to financial inclusion, the working approach guiding this study is the one which was adopted by the World Bank in its reference framework for financial inclusion strategies (Pearce & Ortega, 2012). A comprehensive approach to financial inclusion addresses three dimensions, first dimension is access to financial services and products, second dimension is usage of financial services and products and third dimension is quality of financial services and products. This is shown in **Figure five** depicting each of the described research variables (ibid).

Access refers to being able to reach financial services and product (Pearce & Ortega, 2012). In order to expand access, potential barriers challenging the ability of financial institutions in reaching marginalized or underserved consumers should be identified and then acted upon (ibid). The second dimension is usage which addresses the frequency and the regularity of the consumption of financial services and products(ibid). Usage refers to whether consumers are capable of taking full advantage of financial services and products (ibid). The third aspect of financial inclusion addresses quality, which refers to degree of benefit consumers assume from financial services and products (ibid).

This approach was specifically chosen because it offers a broad and a multidimensional definition of financial inclusion, that helps in extending financial inclusion beyond the erroneous assumption that inclusion is achieved simply by adding more access points (Triki & Faye, 2013). A more complete concept for financial inclusion, should consider along with access the frequency by which clients use financial products/services and the extent to which financial services/products meet the customer's needs (ibid). These dimensions as shown in **Figure 5** represent a framework which can act as a multidimensional guide for policy makers to develop financial inclusion (ibid).

AFI (2013) considers access and usage as the two basic dimensions of financial inclusion, as despite the importance of the quality dimension, it is a complex one both conceptually and in establishing indicators for measurement. Although efforts to advance financial inclusion should work on all three dimensions at the same time, priorities should be set. When setting priorities for assessment of financial inclusion, a number of countries collect information first related to access then usage and then later quality. This is because data on access is more easily collected than for usage and quality (Triki & Faye, 2013)

3.1.1 Dimensions of Financial Inclusion

Below are the three dimensions for financial inclusion in more details:

- Access to Financial Services and Products

The first dimension of financial inclusion is access, referring to the capacity of financial service providers which is affected by regulation, market conditions and technological advancements (The process by which financial consumers/investors improve their understanding of financial products, concepts and risks and, through information, instruction and/or objective advice, develop the skills and confidence to become more aware of financial risks and opportunities, to make informed

choices, to know where to go for help, and to take other effective actions to improve their financial well-being, 2012). In order to have a thorough analysis of the degree of access, an examination of barriers from both sides supply and demand side has to be undertaken (ibid). Supply side barriers are those barriers that challenge financial institutions when providing financial services to consumers, while demand-side barriers that affect consumer's ability in reaching financial services (ibid). Access also refers to the ability of consumers to use financial services, that is why it considers physical proximity to financial service providers and the affordability of financial services (AFI, 2013)

2-Usage of Financial Services and Products

Usage addresses the depth of financial services and products (AFI, 2013). Usage refers to the way in which clients use financial services, such as the regularity and duration of the financial product/service over time (Pearce & Ortega, 2012). Usage requires access first, as consumers cannot use financial services if they do not have access in the first place, but that does not mean that access necessarily means usage as not all consumers who have access choose to use financial services or products (ibid). Usage is usually analyzed using information from the demand side (ibid)

3-Quality of Financial Services and Products

The quality dimensions address the capability of financial services and products in meeting the needs of the consumer (Pearce & Ortega, 2012). Measures of quality captures:

- the degree of matching between products and financial services' features and the needs of the consumers
- the array of financial options available to customers

- Consumers' level of awareness and understanding of the financial services and products

Indicators addressing quality could be developed from information from both the demand and the supply side.

3.1.2 Women-owned MSMEs and Financial Inclusion

MSMEs face the greatest constraints when accessing and using finance due to market imperfections, lack of a supportive legal and regulatory framework and shortages in the enabling financial infrastructure (World Bank, 2014). IFC (2010) reports evidence showing a persistent finance gap for MSMEs, which is mainly the result of a mismatch between supply of financial services and products and the needs of MSMEs. Evidence shows that SMEs could make greater contributions to economic development that they currently do especially in developing countries, where SMEs tend to be smaller suggesting the existence of greater constraints to growth especially financial constraints (IFC, 2011). A study led by the World Bank on data from 99 countries shows that small firms contribute significantly to employment and job creation, but their contribution to growth is unclear which suggests obstacles related to access to finance (Ayyagari et al., 2011).

A report by IFC (2011) on women-owned businesses, suggests that the finance gap is even greater for women-owned businesses, due to financial and non-financial barriers. Researchers have pointed to the existence of a gender gap in financial inclusion, Demirgüç-Kunt et al., (2008, 2013), argues that women in the developing world are faced with barriers when accessing the formal banking services as compared to their men counterparts. Women-owned MSMEs are arguably more restricted in terms of business growth as they are more prevalent in small businesses (IFC-GPFI, 2011). Compared to men, women are more likely to be restricted to small service firms with low added-value operate or home-based business in the informal sector (ibid). Access to finance

is one of the most important tools by which businesses grow, without finance businesses will not be able to make any capital investments and hire additional staff (ibid). Therefore, addressing women-owned MSMEs needs in terms of financing should be a critical part of any development effort (ibid)

3.1.3 Role of the Government in Supporting MSME finance

Ayyagari et al., (2011) suggest that policy makers should focus on obstacles affecting MSMEs, with access to finance being among the top obstacles. MSMEs Finance can be a priority area within the overall framework of financial inclusion (Pearce & Ortega, 2012). Countries who place MSMEs finance as their focus should engage in actions promoting an enabling environment for financial inclusion.

AFI (2017) argues that policy makers are playing a critical role in addressing barriers to financial inclusion especially for women as the majority of them in developing countries lack access to financial services. SME finance policies were found to be an effective way to bridge the gender gap in financial inclusion since most of the SMEs are either managed or owned by women. The role of the government especially central banks and financial supervisory and regulatory authorities revolves around three major areas as mentioned in (IFC, 2010; IFC, 2011; World Bank, 2014; AFI, 2016)

1- Supportive Legal and Regulatory Framework

This includes rules and regulations which are designed to can enhance access to finance and developing interventions with the aim of promoting SME finance and collecting and analyzing financial inclusion data (IFC, 2011).

2- Enabling Financial Market Infrastructure

This includes governmental efforts to build an enabling environment including supporting the information infrastructure, and developing a secured transaction system (IFC, 2010)

3- Direct Market Development Efforts

This includes direct governmental interventions to promote MSMEs financial inclusion such as capacity building and training for financial institutions and efforts to raise financial awareness and financial literacy among MSMEs (AFI, 2016).

3.2- Applying the Conceptual Framework on Women-owned MSMEs in Egypt

Figure Five shows a visual depiction of the conceptual framework guiding this study

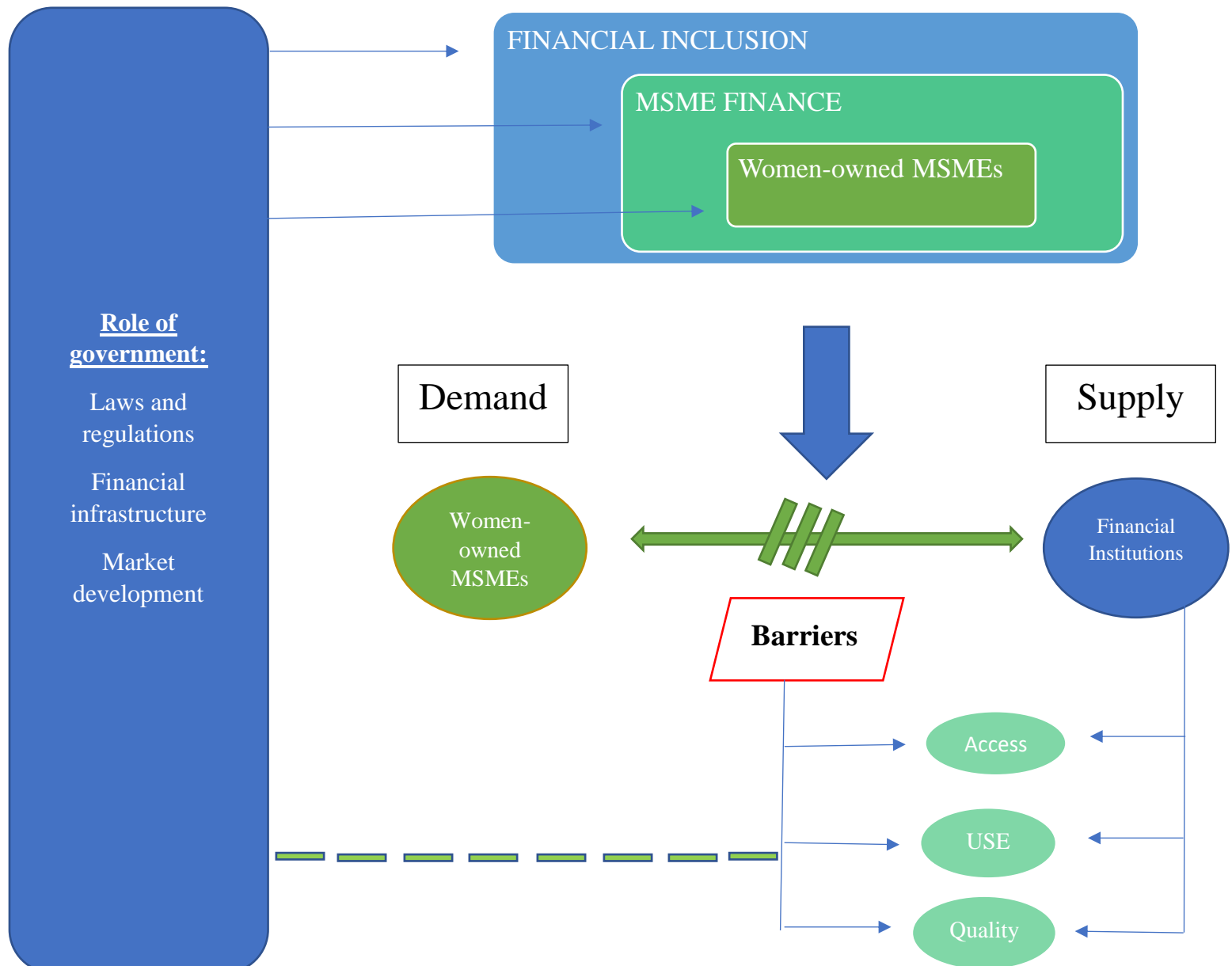


Figure 5: Conceptual Framework

Source: Author's analysis based on World Bank (2012); AFI (2013); AFI (2016)

Chapter Four: Research Methodology

4.1 Qualitative Research Design

This study follows an exploratory qualitative research design aiming to examine the issue of financial inclusion and women, more specifically women-owned MSMEs. This is mainly to identify or validate key barriers to expanded financial inclusion of women-owned MSMEs, current efforts undertaken by the government (namely central banks and supervisory and regulatory authorities) to promote financial inclusion of women-owned MSMEs and determine how government can integrate women into their financial inclusion policies. The issue of financial inclusion and women is still an untapped research area, which required reaching out to key informants, experts and policy makers in order to attain a comprehensive overview of the subject area of this study. Qualitative research design is specifically chosen for this study, because it is used when “studying a phenomenon or situation in detail holistically and in context, focusing on interpretations and or processes” (Punch, 2006, p. 46). This study explores how research questions which call for exploratory tools. Moreover, qualitative research design enables profound human interaction and allows room for exploration.

4.2 Overall Research Strategy

The main research strategy followed in this study is interviewing. This is in order to collect primary information from key informants. For triangulation purposes, first, the interviewing process included key informants from different organizations. The diversity is mainly in type and nature of the organization. Second verifying the collected data against secondary information as content analysis of main documents involving financial inclusion of women in Egypt is used along with

reviewing interviews done by governmental officials on television or in newspapers or conferences will also be done. This is to ensure reliability and validity of the collected data.

In-depth interviews took place through one-to-one meetings with the selected key informants. The data collection process took two months. The duration of the interviews ranged between 60 to 90 minutes each. In order to ensure a consistent approach, a set of interview questions were developed on the nature of financial inclusion in Egypt, constraints to financial inclusion of women-owned MSMEs and the different interventions on a policy level to address these constraints and promote financial inclusion. In certain cases, more, detailed questions were asked according to the direction of the interview. A detailed interview was conducted with a woman who owns a microbusiness as a brief case study in order to ascertain women's opinion on challenges faced in accessing and using financial services.

Working in financial inclusion of MSMEs myself made it easier to approach key informants and conduct interviews with them. All of the interviews were conducted at the key informants' workplace in person with the exception of one interview which was done on the phone as the key informant was out of Egypt.

4.3 Sample Selection

The sampling approach used in this study is non-probability sampling with a purposive sampling procedure to select key informants. The rationale for choosing this sampling framework is due to the specific nature of the topic on financial inclusion and women, more specifically MSMEs owned by women. Key informants in the financial sector with specific knowledge and expertise on women and financial inclusion are limited, which is why another sampling technique would end up including informants who do not have the proper knowledge and expertise. The selection is done

in a way that guarantees attaining the holistic and comprehensive concept of financial inclusion that this study adopts, while also ensuring diversity in senior level and nature of organizations that deal with subject matter. Based on these criteria a total number of 14 one-on-one interviews were conducted. The interviewees cover international development organizations, a private development international bank, non-for-profit organization primarily dealing with women in Cairo and some rural areas, microfinance organization only dealing with women, the two financial regulators in Egypt, private bank with a special interest in women's financial inclusion, two implementing public organizations working with primarily with MSMEs and women, and one global network working financial inclusion. The following were the 13 interviewees according to the nature of the organization they work for:

- Representatives from the CBE and FRA (regulator & policy maker)

Interviewing public officials from CBE and supervisory and regulatory authorities were critical for this study as their respective organizations are the main bodies responsible for financial inclusion in Egypt. The interviewees gave insightful information about the current efforts done by the government to promote financial inclusion in general and more specifically financial inclusion of women-owned MSMEs. Two interviews were conducted, one with an official from CBE, the other one with a representative from FRA. Having the two financial regulatory and supervisory bodies in the study ensures that all financing tools available for MSMEs are covered and provides the macro picture for the financial market in Egypt.

- SME Finance expert at a private International Development Bank (service provider)

Interviewing an SME finance expert at a private international development bank, which provide finance and technical assistance to SMEs, having also special programs directed at women SMEs

is useful. This is because, the key informant can provide insights on barriers faced by women when accessing and using finance as they deal with women-owned SMEs directly and are involved in their operations. Furthermore, the informant can provide information on what the government can do to promote financial inclusion for SMEs in general and women-owned SMEs in specific

- Gender Expert

The selection of a gender expert working for a non-for-profit organization primary working on the economic empowerment of women, provides more insights on barriers facing women financial inclusion and on how the government promote women-targeted financial inclusion policies. Working primarily with women MSMEs provide hands on experience on businesses owned and led by women, more specifically challenges faced to access and use finance.

- Program Director at an International Non-Governmental Organization (INGO) Financial Inclusion Expert, SME Policy advisor at a financial inclusion global network , Non-banking Financial Service advisor , Insurance Consultant ,and MSME finance Advisor at an international development organization

Having experts from the field provides information on the regulators ‘interventions regarding MSMEs finances and more specifically women-owned MSMEs. Experts also offered insightful information on the effects of governmental interventions, barriers facing banks in financing MSMEs and the role of the government in promoting financial inclusion in Egypt.

- Representatives from the Egyptian Banking institute (EBI) (government informants)

Two informants from the Egyptian Banking Institute (EBI), were selected as participants because they provide insightful information on the role of the implementing governmental agencies and the current ongoing interventions undertaken on their level of operation. Key informant 1 from

EBI provided insightful information on the policy interventions done by CBE for SMEs and EBI role in supporting it. Key informant 2 from EBI, provided information on the financial literacy strategy which is a critical part of this study.

- Representative from the National Council of women (gender expert)

Having a representative from the NCW enriches this study, as it will report on barriers specifically faced by women along with reporting on interventions done on the level of the NCW targeting financial inclusion of women-owned MSMEs

4.5 Data Analysis

All 13 interviews were transcribed separately. The analysis of the interview transcriptions is done with no use of software. The analysis followed the thematic categories of the conceptual framework. The coding exercise was guided by the dimensions of financial inclusion from the conceptual framework. Results were clustered in alignment with these threads from the conceptual framework: demand-side barriers, supply-side barriers and government's interventions in the form legal and regulatory framework, financial market infrastructure and market development.

4.6 Ethical Considerations

Participants' anonymity and confidentiality are guaranteed to make sure to do the participants no harm. Informed consent for participation is collected from participants orally or written to guarantee voluntary participation. The Institutional Review Board approved the proposal of the study on the 19th of September 2017 prior to the data collection process. All possible ethical considerations were considered and approved prior to the data collection.

4.7 Limitations and Delimitations of the Study

The main source of interference in this study revolves around access to information especially that among the key informants are busy government representatives who were not willing to participate in the study due to their busy schedules. Furthermore, some of the interventions which are planned by CBE and FRA were not included in this study, because participants could not disclose information concerning draft strategies or efforts still underway for reasons of confidentiality.

Another source of interference which would limit the generalization of the results from this thesis is the small sample size which is mainly due to the limited number of experts on the topic of women and financial inclusion in Egypt.

Chapter 5: Data Analysis and Findings

The interviews provided insightful information on the MSME finance market in Egypt, taking into consideration the comprehensive approach to financial inclusion. Throughout the exploration, interviewees reported on MSMEs finance barriers affecting the three dimensions of financial inclusion as identified by the conceptual framework, shedding light on barriers specifically faced by women-owned MSMEs. Interviewees then reported on the current ongoing governmental efforts by the CBE and FRA to expand financial inclusion of MSMEs, if women were integrated in these initiatives and how could these initiatives be more women targeted

Accordingly, primary data WERE organized under two overarching clusters as highlighted in the conceptual framework, barriers and role of the government which includes current on-going interventions. Each of these overarching clusters touch on the three dimensions of financial inclusion and are discussed primarily for MSMEs in general then specifically for women-owned MSMEs; access, use and quality.

5.1 Barriers impeding Financial Inclusion for MSMEs

The analysis of barriers challenging expanded financial inclusion of MSMEs in general and women -owned MSMEs in specific is in alignment with the three dimensions representing the comprehensive approach to financial inclusion as identified in the conceptual framework. Barriers mentioned by the respondents in this study were categorized into two categories demand-side barriers and supply-side barriers, included in these barriers are any laws or regulations or deficiencies in the financial market infrastructure which affects the supply or demand of financial services.

There was an agreement among all participants of the study that women-owned MSMEs face the same barriers as male-owned MSMEs, in addition to that they face heightened or additional barriers due to their specific nature as being owned by a woman. The Gender expert (Interviewed in 2018) said *“women-owned MSMEs face the same barriers as men in access and using finance, however there are extra challenges faced by women”*. A representative from the NCW (Interviewed in November 2018) reported that *“There are specific additional challenges faced by women-owned MSMEs in accessing finance compared to their men counterparts. These challenges are gender-specific barriers”*.

Accordingly, in discussing and analyzing barriers to expanding financial inclusion of MSMEs, barriers will be discussed in general first then specific application will be conducted on women-owned MSMEs if applicable.

5.1.1 Supply-Side Barriers

During the exploration of barriers that challenge financial institutions when reaching out and providing services to MSMEs, **most of the respondents commented on challenges faced by banks**. This might be because banks are the most common and dominant financial institution in Egypt (Nasr, n.d; Alshyab et al., 2018) and, also across countries as pointed by Beck et al, (2008) and IFC (2010), as banks represent the main source of external funding for SMEs in most countries. However, to address the comprehensive nature of financial inclusion as adopted in this thesis, respondents were also asked to report on non-banking financial services such as insurance, factoring and leasing.

A- Risk Aversion of banks

➤ Banks and Microbusinesses

The microfinance expert (Interviewed in November 2018) commented on the outreach of banks to microbusinesses *“There are currently only four banks in Egypt dealing directly with microbusinesses When it comes to credit, Banks are not interested in microbusinesses, because they are perceived as a high credit risk and they are also harder to reach which makes banks incur more costs”*. Financial inclusion expert (Interviewed in November 2018) explained the reason behind the perception of microbusinesses as high risks *“This is mainly because of lack of information provided by microbusinesses. Microbusiness usually do not have formal financial documents that can speak about their financial soundness”*.

Financial inclusion expert reported on how banks deal with microbusinesses *“The maximum amount of a loan supplied by a bank to a microbusiness is 100,000 Egyptian pounds, which is not given from the first transaction. Banks have a tier system, in which microbusiness reach the maximum amount over a number of credit transactions as reported by the financial inclusion expert (Interviewed in November 2018)*. This means that microbusinesses must prove their credit worthiness first, through paying back the first loan which constitute a fraction of the EGP 100,000 before receiving the full amount of credit available to them. This tiering system suggests lack of trust between banks and microbusinesses due to the perception of microbusinesses as being a higher risk.

As pointed out by the findings of this study, banks in Egypt have very limited relationship with microbusinesses because they are perceived as high risk, incur a lot of costs to reach and lack formal documents , which matches evidence found from across countries as reported by the World

Bank (2014) as banks offer limited credit to microbusinesses due to their lack of formal documents, lack of collateral and high transaction costs.

➤ ***Banks and SMEs***

As for SMEs, *“until recently, banks were afraid to finance SMEs especially small ones because of risk of default. They focused on large businesses, ‘crème de la crème’. However, banks were unaware that focusing on large businesses only increase their risk as they were putting all their eggs in one basket. At the same time SMEs didn’t know how to deal with banks”* as mentioned by EBI informant number 1 (Interviewed in November 2018). SME finance expert (Interviewed in October 2018) provided an explanation for that *“Before 2008, Banks did not know the SME market potential, they didn’t know its importance and they had little interaction with them which contributed to their perception of SMEs as being a higher risk and led them to charge SMEs higher interest rates”*. SME banking professional (Interviewed in December 2018) argued that *“after the recent lending guidelines issued by CBE, banks are welcoming SMEs and are placing them as priority target segment”*

Program Director of an INGO (Interviewed in November, 2018) added that there are some regulations which increased banks’ aversion of SMEs stating that *“Egypt now introduced a new bankruptcy law, however the old bankruptcy law was among the barriers affecting the supply of financial services to SME because the court played the key role in declaration of bankruptcy which made the process complicated and timely making it difficult for the bank to recover defaulted loans”*

Behind the risk aversion of banks towards SMEs is banks’ lack of interaction with SMEs and lack of information provided by SMEs to banks especially pertaining to their financial status. One can infer that the situation in Egypt matches other developing countries as data provided by Beck et

al., (2008) from survey of 91 banks in 45 countries suggests that banks in less developing countries have less exposure to SMEs and charge them higher interest rates. However, this study report that banks perceive macroeconomic instability in developing economies as the main barrier affecting SME finance (ibid)

➤ ***Banks and Women-owned MSMEs***

Banks can be even more risk averse when dealing with women-owned MSMEs as SME finance expert (Interviewed in October 2018) pointed out that “*although banks do not intentionally grant credit to women businesses at a higher interest rate, however loan officers were sometimes stricter with women than men. Reasons behind this is perception of women being more hesitant, worried, and not paying full attention to their business*”. Gender expert (Interviewed in October 2018) argued that “*there are some factors pertaining to women that make them less attractive to banks , thus making banks more risk averse towards them , like for example inability to provide collateral, being less capable of providing a convincing application form, and being less confident about her ideas or businesses*” It appears from the findings of this study that some characteristics of women-owned MSMEs in Egypt like being less financially literate and less confident of their business is the reason behind bank’s perception of women-owned MSMEs as being a higher risk . This suggests that banks do not intentionally discriminate against women, but in some cases loan officers disapprove of women’s applications or charge them a higher interest rate because they are perceived as higher risk.

The literature suggests similar findings as (IFC, 2011) justifies creditors risk aversity towards women because they know little about. It reports that creditors might be discouraged to lend to women if they are perceived to be of a higher risk whether this perception is built upon facts or

experience or incomplete information (ibid). In a study by Demircuc-Kunt et al., (2013), the authors reported that some characteristics pertaining to women businesses might lead them to have lower credit scores like having weaker loan application, low financial literacy rates and a weaker business background. AFI (2016) gives another justification to banks being risk averse when giving credit to women, the justification would be lack of collateral as women find challenges providing traditional collaterals.

B- Limited Capabilities of Banks and other financial institutions in dealing with MSMEs

There was an agreement between the participants of this study, that banks need to work on their internal capabilities to be able to deal better with MSMEs especially women-owned MSMEs.

“In Egypt before 2008, banks did not know what SMEs are, they didn’t deal with SMEs, and it was not in their radar for targeted customers and microbusinesses was not even mentioned as a word” as mentioned by EBI informant number 1 (Interviewed in November 2018). MSME finance advisor (Interviewed in November 2018) added that “in recent years banks’ methodology of dealing with SMEs have been changing, this was due to government’s increased focus on SMEs. Placing more importance on SMEs, banks began to establish SME departments focusing on targeting SMEs”. The problem was:

“Banks considered SMEs the same as large businesses, with the only difference being in size” as articulated by the program director at INGO (Interviewed in November 2018). This was also reinforced by EBI informant number 1 (Interviewed in November 2018) who reported that “Banks took the employees from the corporate departments and placed them in another department and called it an SME department but unfortunately operating with the same mentality of the corporate department. Bank employees have limited knowledge about SME financing needs and their

different business cycles” SME finance expert (Interviewed in October 2018) argues that “Bank employees have limited knowledge of the importance of the MSME sector, thus they prefer larger customers which makes it easier for them to achieve their budgeted targets”.

It can be suggested that banks limited capability in dealing with MSMEs is due to lack of awareness of the SME sector by banks employees especially loan officers who used to only deal with large enterprises, thus they lacked awareness on the SME sector, its specific characteristics, operations and different business model which made them deal with SMEs the same way they dealt with large customers. However, each SME sector has its own business model, with its different financing needs, with loan officers not trained to deal with changing needs of SMEs thus they might provide with an inappropriate financing scheme or product.

The limited relationship between banks and SME was also reported by Beck et al., (2008) who mentioned that banks in general are less exposed to SMEs. This point is also supported by ILO (2016, p. 27) which reported “Commercial banks are also poorly equipped to service smaller-sized companies, opting preferentially for the safer higher end of capitalization”

Financial institutions especially banks in Egypt have limited capabilities when dealing with women-owned MSMEs as most of the times they do not take gender differences into consideration. ILO (2016) states that financial institutions are considered gender-sensitive when they take into consideration the unique needs of women and the specific challenges faced by women when delivering their services and products in an environment free of gender bias.

Lack of gender sensitivity was pointed out by all respondents who deal with women financing.

Gender expert (Interviewed in October 2018) expert argued that:

The problem is not lack of access, there is always money however the main problem is that banks are not gender-sensitive because:

- *Banks 'environment are antagonistic for women especially those who own micro and small businesses, they feel that banks are impersonal. Women feel more comfortable with microfinance institutions because they feel it is more personal. So, they prefer taking a loan at a high interest rate because they know the loan officer as opposed to going to banks which might be cheaper but more intimidating.*
- *Loan officers are not trained to deal with women, they are unaware of the specific difficulties faced by women and their business needs*
- *Working hours of banks might not be suitable for a woman with family responsibilities*
- *Women in rural areas might find it hard to get to a bank branch*
- *Banks have complicated procedures for credit including a lengthy application form, audited financial statements, business plan, and a feasibility study, which given the women's limited financial literacy can be difficult to adhere with*

MSME finance advisor (Interviewed in November 2018) added that *“Banks are not accommodating women's needs in their operations, for example loan transactions take place over a window which is repelling for women because they don't feel comfortable speaking about their financial needs in the open”*. Microfinance expert (Interviewed in November 2018) argued that *“Women, especially low-income women resort to their family and friends to raise money for opening a business as opposed to going to banks because it is safer and easier”*.

It appears from the findings of this study that financial institutions especially banks have limited knowledge on women's needs thus they barely take it into consideration when training their employees, or when designing their work space, their products, their marketing materials and their delivery mechanisms. This can make women consider banks as an inappropriate and a difficult financing tool, when considering external financing options. This matches similar findings on

developing countries by (IFC, 2011) which reported that banks are not adapting their operations to be fitting women's needs for example opening hours or the availability of banks outlets. Due to culture and norms women entrepreneurs face greater challenges in their mobility and face higher demands on their time (ibid). A MFW4A (2014) report on challenges faced by Africa women which mentioned that delivery mechanisms of banks do not adapt to women's needs especially low-income women as banks did not design their branches to be an environment which attracts women. Banks limited physical outreach and business hours do not women's challenges on mobility into consideration (ibid).

C- Lack of variety of MSME financing products

Financial inclusion expert (Interviewed in November 2018) commented that “*although banks are targeting MSMEs, but there aren't a good variety of MSME financing products available*”. SME finance expert (Interviewed in October 2018) argued that “banks are still working on building a portfolio of SME products that can fit different business needs of SMEs”.

Lack of MSME products is not just limited to the banking sector, but also in the non-banking financial services. As the insurance consultant (Interviewed in October 2018) argued that “there are very limited insurance products which are designed for MSMEs, usually MSMEs are offered the normal products which in most cases does not meet their needs. MSMEs needs a comprehensive insurance product, one that can cover all their risks in a single insurance policy”. The non-banking financial services advisor (Interviewed in October 2018) also added that “*there is lack of products specifically designed and targeted for SMEs, however leasing and factoring companies are working familiarizing themselves with the SME market, thus developing products which suit their needs.*”

This can be due to lack of data available on SMEs and also lack of awareness of financial institutions about the MSME market as elaborated above.

Women also suffer from lack of financial products that are tailored to their needs. Gender expert (Interviewed in October 2018) articulated that *“there are very little banking products in the market which are specifically designed to target women, which says that women are not among the priority target customers for banks”*. This barrier has been reported by (IFC, 2011) in its report on strengthening access to finance for women-owned businesses, as financial institutions base their products on a profile which does not suit women. Banking products are not gender-tailored, making it unsuitable for women’s business requirements (MFW4A, 2014).

5.1.2 Demand-side Barriers

A- Low Levels of Financial Awareness and Financial literacy

There is consensus among the participants of the study that low levels of financial awareness and financial literacy represent a key barrier impeding the demand of MSMEs for financial services. *“SMEs, especially smalls ones don’t know how to deal with financial services especially banks, they don’t know what is required from them or if they are eligible or not. They have little knowledge about the array of services available, documents required, and eligibility criteria.”* (SME finance expert, Interviewed in October 2018). EBI informant number 1 (Interviewed in November 2018) reported that *“Until recently, SMEs did not have any relationships with banks, so they didn’t trust banks and didn’t know how to build an effective relationship with Banks. Some SMEs also did not deal with banks because of religious reasons, as they are not Sharia compliant”*. SMEs were new to the banking sector, they had little awareness about how banks operate and how to deal with them. MSME finance advisor added that *“SMEs might have access to banking finance but choose*

not to use it. They feel uncomfortable dealing with complicated numeric transactions, as they do not understand yield, maturity or calculating interest rates. Financial inclusion expert (Interviewed in November 2018) adds that “*SMEs especially micro and small businesses do not know how to file their documents properly when taking out loans from banks, this is because their financial records are not in order*”.

This is mainly because MSMEs are new to the formal financial market because as pointed out in the literature, they depend mainly on informal sources of finance and internal financing sources including savings, revenues retained or funds from sale of assets (IFC, 2010). According to Nasr (n.d), most business owners are incapable of providing banks with solid financial information and business plan. which might suggest that the problem might not be in access, but in usage. This also can be a problem more related to limited financial skills as financial skills refers to being able to calculate interest rates, understand yield, and maturity (Gradstein et al., 2018) SMEs face difficulties in following the procedures of banks, mainly bank requirements addressing financial performance such as presenting financial statements. This is mainly due to most MSMEs in Egypt operating informally (Nasr, n.d; Saif & Ghoneim, 2013).

“SMEs have little knowledge about the non-banking financial services available to them, when they need finance, they go automatically to banks completely unaware that their needs might be fulfilled elsewhere more easily” (Program Director at an INGO, Interviewed in October 2018). Program director highlights the lack of awareness problem, which makes SMEs focus on banks only as source of external finance, completely disregarding other tools like leasing and factoring. This can be due to the non-banking financial market being underdeveloped and still in its primitive phases (Alshyab et al., 2018)

All participants of this study **agreed that financial literacy and awareness represent a higher barrier for women-owned MSMEs especially for micro and small businesses.** Financial awareness is the main barrier for microbusinesses owned by women as, a representative from the NCW (Interviewed in November 2018) reported that *“some women are afraid to enter banks, they don’t know what to find inside it. Women who own microbusinesses fear the organization as a whole, this is especially true for women in the rural areas. Moreover, women who own microbusinesses are completely unaware of banking products”*. As pointed out by the gender expert most of the women who own microbusinesses live in the less privileged areas of Cairo or in rural areas, the Gender expert (Interviewed in October 2018) adds that *“in these areas, it is a big shame for women to take a loan, because other people would think that they don’t have enough money”*. *“One woman, wanted to sell her educational certificate to get a loan”* (SME expert, Interviewed in October 2018), this suggests that women have zero to very little knowledge about financial institutions, their operation and their products.

Low financial awareness and literacy levels among microbusinesses owned by women in rural areas were also mentioned by the MSME finance advisor (Interviewed in November 2018) who stated that *“When speaking about their business ideas to potential investors, women did not know how to present their businesses financially. Most of the times women confused their personal problems with their financial problems”*. Most of the women who owned microbusinesses did not understand the term “financials” and did not have a clear distinction between their home finances and the business finances. This also makes women feel uncomfortable when presenting their businesses to obtain potential credit from banks which sometimes discourages credit officers from providing them with the amount of credit they asked for.

BOX 1- Case Study B.F Story – perseverance and ambition in the face of family conflicts and societal constraints

B.F is a young fresh graduate living in Suhag, who has a bachelor's in agriculture engineering. She comes from a very big family, in which women mainly do nothing but house chores, rarely finish high school and are married at a very young age. B.F was a unique student from a young age, she studied and helped the male members of her family in their agriculture business. She became passionate about agriculture and wanted to find ways to make the process more efficient, that's when she had the idea of using agricultural waste to generate energy in the form of biogas units. B.K faced several problems in establishing her business, the main problems were mainly related to cultural and societal barriers, as she lived in a community where women do not work outside their home and were not supposed to have an independent source of income. However, B.K insisted on her idea and with the help of one of her brothers and the limited savings she constructed the biogas units. Trying to expend and grow her business, B.K needed access to an external source of funding, which was available only through an MFI, because she has little knowledge of banking products and had little room for mobility to go outside her village to seek other sources of finance. B.K is now willing to expand however she is afraid of dealing with large financial institutions, that is why she registered for management education program administered by one of INGOs

The issue of financial awareness and literacy is different when it comes to small and medium sized women-owned businesses as opposed to microbusinesses. Gender expert (Interviewed in October 2018) highlighted the difference stating that *“women who own small and medium sized businesses*

are aware of financial services and the different products available. However, their problem lies in pitching their ideas properly and in choosing the right financial product that suit their needs”.

Shortages in pitching and presentations skills was also mentioned by SME finance expert (Interviewed in October 2018) who stated that “*women are usually shy when presenting their ideas to bankers which might affects banks ‘ability to offer credit and also affect credit terms’*”

The above findings suggest that small and medium-sized women business owners have some sort of financial awareness; however, they cannot make proper choices as to which financial products best suiting their needs. This can suggest lack of financial capability as a barrier to increased uptake and usage of financial products by small and medium-sized businesses owned by women. Lack of presentation skills and confidence in pitching ideas was also mentioned in the literature as according to OECD (2011) women in the MENA region who have poor marketing and financial skills, find it difficult to present their ideas and projects to potential investors or bankers. Women who have lower marketing and financial education face challenged in presenting their ideas to financial institutions which might affect the choice of financial institutions to give them credit and the credit terms.

B- Lack of Collateral for Lending

As mentioned in the literature, most of the banks require some sort of collateral for lending to businesses, with real estate being the most common accepted form of collateral (Beck et al, 2008). There was a consensus among the participants of the study that lack of collateral is a main obstacle challenging access and usage of bank loans. As pointed out by SME finance expert (Interviewed in October 2018) “*SMEs might be able to afford to pay interest rates charged by the banks, however they are unable to put forward collateral*”. This was also pointed out by the program

director at INGO (Interviewed in November 2018) who mentioned that “*collaterals represent a high entry barrier for SMEs*”.

A lack of secured lending framework due to lack of a collateral registry and a secured lending law was pointed out by participants as a possible deficiency in the enabling environment. Financial inclusion expert (Interviewed in November 2018) added that “*most MSMEs in Egypt do not have real estate collaterals which are the form of collaterals usually required by banks. However, they have plenty of movable collaterals which are not accepted by banks this is because until recently there was registry for movable assets*”. Non-banking financial services advisor (Interviewed in October 2018) commented that “*Egypt recently issued a secured lending law allowing the use of movable assets, but until 2018 the registry was not established which affected the use of movable assets as collateral*”. Lack of collateral represent as a barrier is affected by other barriers in the enabling environment which is the lack of secured lending transaction framework.

5.2 Current Efforts Aimed at Expanding Financial Inclusion of MSMEs

Participants of the study were asked to report on the most recent efforts directed at promoting financial inclusion **undertaken by supervisory and regulatory authorities, which are the Central Bank of Egypt and the Financial Regulatory Authority**. This study is focusing on financial inclusion efforts targeting expanding access and usage of financial services by MSMEs in Egypt, more specifically women-owned MSMEs. The efforts are categorized according to the role of the government as highlighted in the conceptual framework into three main categories, rules and regulations, financial infrastructure efforts and market development efforts led, developed, administered or undertaken by CBE or FRA among which is a diagnostic study on financial inclusion in Egypt.

Participants of the study were in agreement that financial regulators are the main driver behind the efforts for financial inclusion of MSMEs in Egypt. Program director at INGO (Interviewed in November 2018) highlighted the role of regulators as being *“change agents, paving the way for financial inclusion. Financial inclusion is a critical step towards an inclusive financial system”*. Financial inclusion expert (Interviewed in November 2018) added that *“Banking sector is a heavily regulated sector this sometimes leaves little room for innovation, regulators should establish policies as incentives and act eye-openers for the financial market”*

It can be suggested that in Egypt financial regulators and supervisory authorities are not just seen as official authorities responsible for supervision and ensuring compliance with rules and regulations but are also considered as champions of change, and owners and coordinators of the financial inclusion framework and direct contributors to the economic development process. Expanded role of regulators in Egypt matches what happened across countries which was pointed out by Ardic et al. (2011), who reported that financial regulators are expanding their role beyond their traditional tasks of compliance, monitoring and supervision to assume more market development roles. This is through focusing on financial inclusion as a tool for financial sector reform (ibid).

5.2.1 Supply-Demand Side Market Diagnostic Study

CBE representative (Interviewed in December 2018) reported that *“Egypt is currently developing a national financial inclusion strategy; however, it is still in the early phase. A diagnostic supply/demand national study is one of the preliminary steps along establishing a financial inclusion strategy”*. As pointed out by the SME policy advisor (Interviewed in November 2018) *“one of the most critical interventions that the CBE is currently leading is a fully-fledged market diagnostic study to examine both supply and demand sides of financial inclusion in Egypt. Target*

segments of this study households, MSMEs and women. He then articulated the main objective of the study as being *“the basis for understanding the MSME finance landscape in Egypt, through looking at both the demand and the supply side of financial inclusion addressing access, usage, quality dimensions”*. This means, that this diagnostic study will capture the current status of financial inclusion in Egypt through establishing baseline indicators for access, usage and quality dimensions of financial inclusion. Program director at INGO (Interviewed in November 2018) added that *“these indicators will then be used for monitoring and evaluation of any future financial inclusion efforts”*.

Program Director of an INGO(Interviewed in November 2018) highlighted the importance of the diagnostic study in the following points

“- Evidence-based policy making: This study will provide detailed information about access, usage and quality of financial services in Egypt, for households and MSMEs. Thus, acting as guide for policy makers for the identification of financial inclusion priority areas, policy directions and reforms which will then feed into a national financial inclusion strategy

-identification of key constraints and barriers that prevent expanded financial inclusion of MSMEs both from the demand and supply side

The SME policy advisor (Interviewed in November 2018) added that *“demand-side diagnostic study tells us what SMEs want in terms of financing. If we can understand the demand-side, then we can form the right supply-side products”*. This means that financial institutions need to examine MSMEs demand pattern for financial services, their specific needs in terms of products nature, conditions, and delivery channels in order to design appropriate demand-based products that meet those needs.

One can infer from the above that Egypt is at the formulation phase of developing its NFIS, according to AFI (2016 p. 6) “diagnostic studies form a major task of the formulation phase”. It can also be suggested that Egypt is working on the stocktaking: data and diagnostic component of its NFIS as pointed out in the NFIS reference framework developed by Pearce and Ortega (2012) which involves conducting financial inclusion diagnostic studies. CBE is using the information from the diagnostic study in the same way as was suggested by Pearce and Ortega (2012) and AFI (2016) as a tool for designing country-specific NFIS. Diagnostic studies provide a comprehensive and detailed analysis of the current financial inclusion status, assess impeding constraints and form the basis of determining future policy priorities (ibid).

Gender is a part of the NFIS diagnostic study, as women is one of the target segments of this study, CBE representative (Interviewed in December 2018) expressed that *“CBE is committed to halve the gender gap by the year 2021, this study will provide a baseline for gender through examining the three dimensions of financial inclusion, access, usage and quality of both formal and informal financial services. This information will help to develop a gender-sensitive financial inclusion strategy”*. The diagnostic study will provide baseline data for households and MSMEs gender disaggregated, findings, and recommendations for future policy actions and reforms will also be gender disaggregated.

5.2.2 Laws and Regulations

The following part will focus on recent laws and regulations including lending guidelines notes aiming at promoting a supportive legal and regulatory framework for MSME financing. Laws and regulations are further categorized into lending guidelines for MSME financing, and non-banking financial services laws and regulations.

A- Lending Guidelines for MSMEs

Experts interviewed highlighted the role of the CBE in promoting access and usage of SME finance, through the following interventions in chronological order:

- 2008: Exemption of required reserves for loans to SMEs

EBI informant number 1 (Interviewed in November 2018) stated that “*one of the very first interventions targeting the SME market was in 2008, the CBE issued a regulation which exempted banks from the required reserve ratio of 14% on any credit facilities provided to SMEs. This intervention aimed at encouraging banks to enter the SME market, exemption of banks from the required reserve ratio increases banks’ profitability from lending to SME*”. One of the access constraints mentioned earlier is risk aversion of banks and their reluctance to enter the SME market, it can be suggested that one of the attempts to face this is raising interest in the SME market through incentives like: exemption of the required reserve ratio.

- 2015-2017: **There was an agreement among the participants of this study that CBE efforts in the period from 2015 to 2017 were the main and the most important interventions for MSMEs financing:**

- 2015: unified definition for MSMEs according to CBE circular dated 7 Interviewed in December 2015⁶

- Establishment of a unified MSME definition: in light of the different definitions used by financial institutions in Egypt, CBE issued a unified definition for MSMEs using annual revenues for classification of already established

⁶ <http://www.cbe.org.eg/en/Pages/HighlightsPages/Circulardated7122015e.aspx>

enterprises and paid-in capital for new enterprises’, businesses were classified into micro, very small, small and medium enterprises

- The definition of MSMEs was later changed according to guideline note dated 5 March, 2017⁷⁷, changing the classification of businesses to three categories which are micro, small and medium businesses using annual revenues for classification of already established enterprises and paid-in capital for new enterprises’

EBI informant number 1 (Interviewed in November 2018) highlighted the importance of establishing a unified definition for MSMEs *“previously, there was no unified definition of SMEs, every financial institution used its own definition which made data consolidation and comparability very difficult.”*.

SME policy advisor (Interviewed in November 2018) added that *“having a unified definition improve the data landscape for MSMEs “*. The CBE established definition is the first formal unified definition used by all banks in Egypt, this definition is used to categorized MSMEs and also for data reporting and collection by CBE. The importance of reliable data collection is highlighted by the IFC (2011) as a preliminary step towards developing SME financing action plans and objectives. Harmonizing the definitions is necessary for data measurement and comparability and for designing and implementing of future policies.

⁷⁷ <http://www.cbe.org.eg/en/Pages/HighlightsPages/Circular-dated-5-March-2017-regarding-amending-some-items-of-the-SMEs-initiatives.aspx>

- 2016: CBE issued a number of lending guidelines to banks in an attempt to encourage banks to finance SMEs including the following:

According to circular dated 11 January 2016 for encouraging banks to finance SMEs ⁸

- Banks are to dedicate 20% of the loan portfolio of banks to be dedicated to SMEs. Program director (Interviewed in November 2018) reported that “*CBE has made a commitment under the Maya declaration to improve financial inclusion, one of which is targeting SMEs. CBE is availing 200 billion Egyptian pounds to the SME sector, mandating banks to dedicate 20% of its total loan portfolio to finance SMEs over a course of 4 years*”. According to the mandate, CBE has also asked banks to provide them with plan on how they are going to achieve this percentage of loans to SMEs, thus encouraging banks to find ways to reach the SME market.
- Reduced interest rates for Small enterprises:
5% interest rate to small enterprises: Banks can deduct the total direct loans amount provided to small enterprises from the required reserve amounts as long as they offer loans at a reduced interest rate of 5%. Priorities given to industrial companies working in backward integration, import substitution, labor-intensive projects, innovative projects and export companies

According to the Intervention for medium sized agricultural and industrial companies dated 22 February 2016⁹, CBE is to avail 5 billion Egyptian pounds to be used by banks

⁸ Circular dated 11 January 2016- <http://www.cbe.org.eg/en/BankingSupervision/Pages/Circulars.aspx?p=8>

⁹ Intervention for medium sized industrial and agriculture companies
<http://www.cbe.org.eg/en/BankingSupervision/Pages/Circulars.aspx?p=7>

are to finance medium-sized companies working in the agriculture and industrial sectors with a reduced rate of 7% for medium term and long-term financing. Loans at reduced interest rates to be provided for companies aiming at installing new production lines or purchase of new machinery.

➤ **2017: CBE continued with issuing SME lending guidelines**

According to guideline note dated 5 March 2017 ¹⁰:

-medium-sized companies working in renewable energy sector is to benefit from the reduced interest rate of 7%

-availing 10 billion Egyptian pounds (layered) from the 20 billion previously mentioned for banks to lend medium-sized enterprises working in industrial, agriculture, and renewable energy sectors at 12% for short-term financing

- According to guideline note dated 23 May 2017¹¹: Microfinance loans to be provided directly to microbusinesses or through microfinance companies and microfinance institutions licensed by FRA to be included in the 20% required quota for SME lending by CBE.

-According to guideline note dated 12 July 2017¹²: decrease of the minimum limit of annual revenues for small enterprises working in Agriculture, agri-processing, dairy, fodder, fish, poultry and animal production to be 250,000 Egyptian pounds instead of 1 million Egyptian pounds. Those companies will have a lending rate of 5%.

¹⁰ Circular dated 5 March 2017 regarding amending some items of the SMEs initiatives
<http://www.cbe.org.eg/en/BankingSupervision/Pages/Circulars.aspx?p=4>

¹¹ Circular dated 23 May 2017 regarding the Microfinance initiative
<http://www.cbe.org.eg/en/BankingSupervision/Pages/Circulars.aspx?p=4>

¹² Circular dated 12 July, 2017 regarding financing small companies engaged in agribusiness, fisheries, poultry, and livestock.
<http://www.cbe.org.eg/en/BankingSupervision/Pages/Circulars.aspx?p=3>

SME policy advisor (Interviewed in November 2018) highlighted the importance of the CBE lending guidelines “*using incentives and availing funds for SME lending are important tools for raising interest of banks in the SME market*”. Program Director of an INGO (Interviewed in November 2018) commented that “*banks are for profit organizations, encouraging banks to lend to SMEs through increasing banks’ profitability and the same time reducing costs for SMEs is a good tool for increasing access and usage for SMEs*”. Microfinance expert (Interviewed in November 2018) added that “*These lending initiatives indirectly help the informal market through including MFIs and microfinance companies under the 20% required percentage for lending portfolio. However, a greater impact on microbusinesses would have been achieved if MFIs could benefit from the reduced interest rates*”. EBI informant number 1 (Interviewed in November 2018) commented on the reaction of banks to the recent lending guidelines “*banks were excited about the new CBE interventions, they wanted to take advantage of it and would like to expand the SME portfolio because they think it becoming more profitable*”

It is evident from the above findings that the government of Egypt is placing more focus on MSMEs in general and more specifically on those working in the industrial, agriculture and renewable energy and is attempting through its financial policies to promote access to finance for MSMEs. The CBE guidelines in the years from 2015 to 2018 represent the main efforts of the government aimed making SMEs more attractive as a segment for banks and also increasing the affordability of credit to SMEs.

Despite the fact that all participants of this study viewed CBE efforts as commendable, there were also some limitations as Financial Inclusion expert (Interviewed in November 2018) mentioned that “*reduced interest rates for SMEs created some sort of structural failure in the market as big companies with big flashy names created smaller companies to take advantage of reduced interest*

rates. So, the intervention benefited companies who were not intended in the first place. In addition to that some banks did not try to reach new customers, as they called their current clientele to convince them with borrowing at the new reduced interest rates". This was also reinforced by SME Finance expert (Interviewed in November 2018) who stated that *"when the CBE guidelines were issued, banks focused on the higher end customers of SMEs, they reached to SMEs who have already some sort of relationship with the bank and did not work on strategies to reach new SMEs".*

The CBE most recent interventions focused on encouraging SMEs to borrow through reducing cost of borrowing and encouraging banks to lend SMEs through exemption of required reserve, however as indicated by the Financial Inclusion expert (Interviewed in November 2018) *"reduced interest rates did not address the main barriers, as banks are still applying the same credit policies".* EBI informant number 1 agreed with this point and stated that *"high costs were not the main barrier faced by SMEs, however their main problem was with bank procedures which did not change with these interventions".* Program Director of an INGO(Interviewed in November 2018) suggested that *"although banks were responsive to CBE's initiatives, however they are already asking about the penalties for not reaching the required amount of 20% lending portfolio to SMEs. May be CBE should engage with discussion with banks and SMEs to see what is holding them back after removing the price barrier".* MSME finance advisor added that *"reduced interest rates initiative comes with credit conditions that SMEs find hard to achieve which why 200 billion EGP availed to SMEs have not been effectively used by banks"*

One can infer from the above that CBE is focusing on expanding the supply of credit to MSMEs through encouraging banks to offer more credit to SMEs, however it can be presumed that these interventions did not address key barriers from the demand side like lack of collateral and low levels of financial awareness and literacy among SMEs and key supply barriers like complicated

banking procedures. This why banks are struggling to reach the 20% as there is still little demand from the SME side. It is also evident that all the above-mentioned CBE lending guidelines while focusing on MSMEs but are not women-targeted as it didn't highlight women-owned MSMEs as interest rates are the same for all SMEs either owned by men or women.

B- Laws for Non-banking financial services

A representative from FRA (Interviewed in October 2018) highlighted the importance of the development of non-banking financial services on the state of financial inclusion in Egypt “*non-banking financial services are at the heart of financial inclusion, people always relate financial inclusion to banks. However financial inclusion ensures an array of financial services including insurance, leasing, factoring and microfinance*”. Program Director of an INGO (Interviewed in November 2018) pointed to the importance of non-banking financial services to MSMEs “*non-banking financial services can be especially relevant to SMEs because they are easier and accessible compared to bank loans. Therefore, development of non-banking financial services should be done on all levels from policy level to market development level*”. Non-banking financial services advisor (Interviewed in October 2018) reported that “*When SMEs need external finance for example to buy a piece of equipment, they automatically go to bank for a loan, however a leasing contract might be more suitable in this scenario which could decrease their cost for initial investment and will also provide the SME with the needed equipment or machinery*”

➤ *Microfinance Law*

In Interviewed in November 2014, Presidential Decree no.141 of 2014 regulating microfinance ¹³ was issued to regulate the provisions of microfinance in Egypt. FRA's board of directors then issued executive decrees related to the specific rules of compliance, supervision and regulation. According to the microfinance law, microfinance are loans provided for business purposes up to EGP 100,000. Under the law, all non-banking financial institutions offering microfinance are under the supervision of FRA. The law allows the establishment of microfinance companies and microfinance institutions (MFIs) which are licensed via the FRA.

FRA representative (Interviewed in October 2018) highlights the importance of the micro finance law in promoting financial inclusion *“microfinance is a significant part of financial inclusion as microfinance is the main tool for reaching the unbanked population. The law aims at protecting the rights of the concerned parties, regulating and supervising the sector. A regulated and a supervised sector encourages financial institutions to enter the microfinance market, thus increasing the competition and offering better services to end customers”*. Program Director of an INGO(Interviewed in November 2018) emphasized the role of microfinance in the financial inclusion process *“microfinance is the entry point to financial inclusion especially for the underserved microbusinesses whose first step towards entering the financial market is through microfinance. Regulating this industry and allowing the establishment of microfinance companies attracts more attention to the sector and leads to its development”* Microfinance Expert

¹³ Microfinance Law <https://www.youm7.com/story/2014/7/6/%D9%86%D9%86%D8%B4%D8%B1-%D9%86%D8%B5-%D9%85%D8%B4%D8%B1%D9%88%D8%B9-%D9%82%D8%A7%D9%86%D9%88%D9%86-%D8%AA%D9%86%D8%B8%D9%8A%D9%85-%D8%A7%D9%84%D8%AA%D9%85%D9%88%D9%8A%D9%84-%D9%85%D8%AA%D9%86%D8%A7%D9%87%D9%89-%D8%A7%D9%84%D8%B5%D8%BA%D8%B1-%D8%A8%D8%B9%D8%AF-%D8%A7%D9%86%D8%AA%D9%87%D8%A7%D8%A1/1762362>

(Interviewed in November 2018) added that *“the new law provided some sort of formality to a market that has been working under the radar for some time now”*.

FRA representative (Interviewed in October 2018) reported that “after the issuance law, FRA established consumer protection guidelines which included regular visits by FRA to MFIs and microfinance companies and developing of a system of handling consumer complaints”

It is evident that the new microfinance law, aims at expanding access to microfinance through amending the guidelines by which existing MFIs work to increase its outreach and value to end-customers and encouraging the establishment of microfinance companies. The establishment of microfinance companies allows new players to enter the market, which would promote competition and also help in moving the microfinance sector beyond the dominations of non-governmental organizations (NGOs)

FRA representative (Interviewed in October 2018) highlighted the importance of the law to women *“although laws and regulations are for all, men and women. However, women are the primary beneficiaries of the microfinance law as the majority of microfinance users in Egypt are women, especially in the rural areas”* Gender Expert (Interviewed in October 2018) agreed with FRA representative stating that *“women prefer microfinance because it is easier to get and safer for them, MFIs also have special products which are tailored for women’s needs”*

As indicated earlier, most of the women’s businesses in Egypt are microbusinesses (ILO, 2016), therefore amending the regulation of the primary method of external finance to microbusinesses in Egypt would promote expanded financial inclusion and encourage women to start and open their own business.

➤ ***Leasing and Factoring Law***

According to the new financial leasing and factoring law No. 176 of the year 2018 ¹⁴, the new law replaces the old leasing law¹⁵ (Law No. 95 of 1995) and the ministerial decree No. 446 of 2003 related to factoring ("Highlights on the newly enacted financial lease and factoring law", 2018)

Law No, 176 for the year of 2018, establishes the definition for financial leasing and factoring. Financial leasing is a financial contract for assets between the lessor and the lessee, which allows the lessee to make use of the asset in return of a fee for a certain amount of time as specified in the contract with the condition that the lessee must have the option to purchase the asset partially or fully ("Highlights on the newly enacted financial lease and factoring law", 2018). Factoring is financing tool which allows factoring companies to purchase existing or future financial rights generated from sales of goods or provision of services (ibid).

FRA representative (Interviewed in October 2018) highlights the new dimensions of the new leasing and factoring law “the new law sets out rules for licensing financial leasing and factoring companies, no company will be allowed to obtain the license unless its activities are limited to financial leasing or factoring or both. A key change in the law is that it gives FRA employees the power to impose the law, failure of the companies to provide FRA with the needed documents might lead to a fine or imprisonment”.

Non-banking financial service advisor (Interviewed in October 2018) emphasized the importance of the law to the financial inclusion of MSMEs as follows:

“This law aims at the development of the non-banking financial services which is especially important for MSMEs as it gives them financing alternatives other than the traditional

¹⁴ ¹⁴ Law No. 176 of the year 2018 : http://www.fra.gov.eg/content/efsa_ar/laws_lease/law_lease1.htm

¹⁵ <http://www.ragylaw.com/~rplfeg/images/file/Financial%20Leasing%20Law%2095%20of%201995.pdf>

route of taking a loan especially when they want to buy an asset which would otherwise be unattainable. The law decreases the fees for financial leasing contracts significantly to be maximum of EGP 500 instead of EGP 3,000 which makes it cheaper for MSMEs to acquire. The law also allows for micro financial leasing and micro factoring which open up new financial tools for microbusinesses other than microcredit”

Leasing and factoring encourages MSMEs to enter the formal financial system, as it gives unique and innovative solutions to their financing problems. Through leasing for example MSMEs have the opportunity to acquire the assets they need without providing collateral which was one of the barriers mentioned earlier affecting the demand for financial services.

It can be presumed from the above that Egypt is adopting a comprehensive vision of financial inclusion which does not just focus on credit but also promoting other financial tools for businesses especially MSMEs. Although this law aims at promoting financial inclusion especially for MSMEs, however it will be challenging to produce an impact without MSMEs being aware of the available financial tools and being capable of using them effectively to their interest.

➤ ***Microinsurance Law***

Micro-insurance was not a part of the current laws governing insurance in Egypt, it was first introduced by FRA which was issued by chairman decision number (902) for year 2016¹⁶.

The insurance consultant (Interviewed in October 2018) highlighted the importance of the new guidelines in the law emphasizing that “

¹⁶ http://www.fra.gov.eg/jtags/efsa_ar/pdf.jsp?itemId=UG38394&itemType=3&parentId=UG38393&parentType=2

The law stipulates that micro-insurance policies to be designed with simple terms, so that end customers can easily understand it

- *Microfinance institutions, microfinance companies, other non-governmental organizations and the post office can distribute microinsurance policies. This is critical addition as before the issuance of this law, insurance brokers and agents were the main distribution channels of insurance policies who were not interested in microinsurance because it does not generate high profit for them.*
- *10 days to be the maximum amount of time a claim to be paid by the insurance company to the microinsurance policy holder. This addition is particularly important for microbusinesses who need to be paid in a short time to be able to resume their business*
- *Microinsurance policies could be printed electronically, which is especially important to businesses in the rural areas who find it hard to get to an insurance company”*

Microfinance Expert (Interviewed in November 2018) added that *“before this law, MFIs were unable to distribute microinsurance policies which was a huge barrier to the expansion of microinsurance. This is because microbusinesses are more likely to obtain insurance from an MFI than an insurance company, as microbusinesses especially women trust MFIs more than they trust insurance companies”*

The new microinsurance law provides risk transfer solutions to microbusinesses, through taking into consideration the following points:

- demand barriers like low financial awareness of micro and small businesses as stipulated above, as the law directs insurance companies to design policies with simple and easy language

- supply barriers like the lack of capability of financial institutions to reach microbusinesses, as the law allows MFIs, banks, the post office, NGOs to as possible distribution channels for microinsurance

5.2.2 Financial Infrastructure Efforts

SME policy advisor (Interviewed in November 2018) highlighted the importance of supporting financial infrastructure in the financial inclusion process “solid financial infrastructure and supportive rules and regulations are the cornerstones for promoting financial inclusion”. This study will focus on improving the financial infrastructure led by CBE or FRA.

Participants of the study agreed that the main financial market infrastructure efforts undertaken in Egypt targeting MSME financial inclusion pertains to the establishment of a credit information bureau and the development of secured transactions framework.

A- Credit Information System

The Egyptian credit bureau “I-Score” was established in 2005 upon the approval of the capital market authority and the CBE (iscore, 2018). The current shareholders are representatives from public and private banks and the Micro, Small and Medium Enterprise development Agency (MSMEDA) (ibid).

I-score is responsible for maintaining a database of credit information for individuals and SMEs in Egypt, this allows I-Score members (primarily banks and financial institutions) to screen potential customers for creditworthiness (iscore, 2018). I Score’s database contains all credit data on individuals and SMEs and also provided a credit score based on the customer’s credit history (ibid).

Program director at INGO (Interviewed in November 2018) highlights the role of I Score in promoting access to finance for MSMEs *“one of the banks problems with SME is lack of credit information on SMEs especially that SMEs find it difficult to keep proper financial records. This discourages banks from providing credit to SMEs. Through I Score, banks can obtain credit history information about SMEs thus assisting them with analyzing their credit worthiness and thus attracting banks to the SME sector”*. SME finance Expert (Interviewed in October 2018) *“a credit information system like I Score promoted the concept of transparency, SMEs used to be a dark segment for financial institutions because they had no way of knowing their correct credit history.”*. FRA representative (Interviewed in October 2018) *“information on microbusinesses are also available on I Score as Microfinance institutions and microfinance companies provide information on their customers”*

The presence of a credit information company or a credit bureau addresses some of the barriers for financial inclusion of MSMEs indicated previously. One of the barriers that I Score can reduce is risk aversion of banks due to the opacity of MSMEs, thus banks can amend its credit conditions according to the credit worthiness of potential clients. MSMEs with good credit history can get loans at better conditions than those with bad credit history. However, one could argue that credit information system reports on companies who had previous dealings with banks or financial institutions, meaning it helps institutions that are already financially included. Companies with no prior dealings with the financial system (which are the prime target segment for financial inclusion efforts) remain opaque to financial institutions.

IFC (2010, 2011) highlights the importance of credit reporting systems for lenders’ as it provides accurate and credible information about the ability of the potential customer to repay the loan. A well-functioning credit report system can be specifically important for SMEs as it reduces adverse

selection and moral hazard, thus assisting in expanding of credit facilities provided and decrease of lending costs. AFI (2016) reinforces the importance of the availability of credit information in expansion of SME lending as it addresses information gaps thus helping lenders with their credit worthiness assessment.

B- Electronic Movable Assets Registry

On 15 Interviewed in November 2015, Egypt had its first movable collaterals law, Law no.115/2015¹⁷, and its executive regulations were issued by the ministry of investment on 15 Interviewed in December 2016 (Salah & El Baradei, 2018). The law provided the legal framework necessary for taking non-possessory security over a range of movable assets (ibid). The movable collateral law allows for the use of movable assets as collaterals which include equipment and machinery, current and deferred debts, inventory or stock and all kinds of intellectual property like patents, trade names and copyrights (ibid). Secured creditors as per executive include financial institutions such as banks, institutions with a microfinance license, institutions with financial leasing licenses.

FRA is the responsible authority for developing and running the movable assets registry, and it assigned the task to I-Score- the Egyptian Credit Bureau to create and manage the electronic movable assets registry with the supervision of FRA (Salah & El Baradei, 2018). **The Electronic Movable Assets Registry** is an electronic system that records and circulate security interests over collaterals as well as making amendments or cancellations to them (ibid)

Program director at INGO (Interviewed in November 2018) emphasized the importance of the movable assets law stating that “*this law is considered a major transformation in the Egyptian*

¹⁷ http://www.fra.gov.eg/content/efsa_ar/laws_efsa/UG39120UG39121.pdf

financial market for the first time in Egypt, movable assets could be accepted as collaterals for credit transactions". Financial Inclusion expert (Interviewed in November 2018) highlighted the implication of the new law to MSMEs *"This law is especially important to MSMEs which had problems in providing collaterals to banks, as it gives them the ability to use movable assets as collaterals for acquiring credit. Having an effective legal framework for secured transaction will enhance access to credit for MSMEs"*. FRA representative (Interviewed in October 2018) highlighted the importance of the establishment of the electronic registry *"the electronic movable assets registry is the heart of the new movable assets law, as it puts the law into execution mode"*. SME finance expert (Interviewed in October 2018) added that *"despite the issuance of the law, banks are still reluctant to accept movable assets. However, this might change after the creation of the electronic movable assets registry"*

One of the major barriers mentioned by participants of this study was a lack of collateral for lending. The new movable assets law, and the development of the electronic movable assets registry addresses this barrier through providing a secured legal framework and enforcement mechanisms for the use of movable assets. This would encourage financial institutions especially banks to accept movable assets as collateral and the same time increasing the demand for credit by MSMEs. The importance of secured collateral framework was addressed in the literature as collateral frameworks addresses market imperfections like moral hazard and adverse selection especially for SMEs thus enhancing SME financing by decreasing the risk and losses of lending institutions (IFC, 2011)

5.2.3 Market Development Efforts

A- Financial awareness and Financial Literacy

➤ Financial Inclusion Awareness Campaign

As pointed out through the literature, financial awareness and financial literacy are a huge part of the role played by the government in expanding financial inclusion of MSMEs (IFC, 2011; World Bank, 2014; AFI, 2016). As reported by the CBE representative (Interviewed in December 2018):

“The Egyptian government is currently working on a national financial inclusion awareness campaign. The first phase of the campaign was a teaser through television commercials introducing financial inclusion through portraying different scenarios for savings, borrowing and the effective use of technology. Almost all commercials portrayed women, which was intended as women empowerment is main pillar in the Egyptian financial inclusion framework. The second phase of the campaign will include more information about financial inclusion for example how can individuals and businesses reach financial institutions and introducing different financial services provided by banks “.

The first phase of the financial inclusion awareness campaign aimed at introducing the term financial inclusion to the public, it adopted the comprehensive nature of financial inclusion through introducing credit, savings and the use of technology to transfer funds.

Some of the participants of the study criticized the campaign. For instance, the MSME finance advisor (Interviewed in November 2018) argued that:

“some of the microbusinesses especially in rural areas, were affected by the advertisements and went to banks but they were rejected as banks still does not have microfinance products.

Before working on the demand side, the government should ensure that its supply side is ready or else any future interventions will not be taken seriously by the public”.

Additionally, the microfinance expert (Interviewed in November 2018) noted that:

“although the campaign introduced the public to the financial market especially banks, however it did not address trust issues, or the unattractiveness of banks to small and microbusinesses especially those owned by women.

To the extent that the woman who was portrayed in the advertisement did not approach banks as she still fears the formal financial system”

Presumably, there is lack of coordination between the different financial inclusion interventions. As the awareness campaign was aired during the same time of the CBE lending guidelines interventions discussed above, but they didn't complement each other. The awareness campaign mainly portrayed women who owns a microbusiness or would like to start a microbusiness and the CBE intervention was mainly targeting small and medium enterprises not microbusinesses, at the same time most banks did not have microfinance projects and did not have products targeting women.

➤ ***National Financial Literacy Strategy***

A national financial inclusion literacy strategy was developed by EBI under the guidance of CBE. EBI informant number 2 (Interviewed in November 2018) reported on the financial literacy strategy development process “

➤ *EBI acted as a coordinator for the financial literacy strategy bringing together relevant stakeholders like the Ministry of Education, Ministry of Finance, ministry of youth and sports, FRA, representatives from public and private banks, international organizations and the Egyptian national post office.*

As a coordinating body EBI organized meetings and workshops, prepares and circulates minutes of meetings and summarizes all discussions and outputs, drafts and present parts of the strategy for open discussion

- *Activities were designed for each target segment of the society. The segments agreed upon are: Children, youth, MSME/entrepreneurs, and formal workforce employees. The initial draft for the strategy did not include women as a separate target segment and women were portrayed under each segment. However, CBE has recommended that women to be dealt with as separate category”*

EBI informant number two expanded on her statement “There is a part dedicated to MSMEs as a target segment for the national financial literacy strategy with the following main activities

- *Preparing a guide including all organizations serving the SMEs sector in Egypt, in addition to all financial and non-financial services presented for this sector*
- *Analyzing financial literacy needs of entrepreneurs and small business owners*
- *Preparing Financial Literacy materials and presentations (two types of materials: the first one tackling personal finance skills (budgeting, planning, project feasibility studies,); the second including tips on how to deal with banks, how to get a loan,)*
 - *Preparing awareness sessions and customized programs for illiterate people starting micro projects “*

EBI has presented the strategy and still awaits feedback as to the implementation process from the CBE. Program director at INGO (Interviewed in November 2018) commented that “the *strategy is still on paper, the most important part which is the implementation process is still missing*”. SME finance expert (Interviewed in October 2018) added that “financial education efforts are single efforts and are uncoordinated”

Despite the fact that a financial literacy strategy addresses the main barrier of low levels of financial awareness and financial literacy. However, the problem lies in moving from theory to implementation. The strategy needs to be implemented properly taking into consideration the specific needs of MSMEs and more specifically women-owned MSMEs and their specific barriers. The current draft of the strategy lacks the gender sensitivity part, as women in all forms and ages need to be considered in the strategy, especially that as pointed out in the barriers subsection and as presented in the literature low financial awareness and literacy levels are higher among women (OECF/INFE, 2013)

It can be inferred from the participants, as pointed out by the SME finance expert, financial education and awareness efforts are disbursed, lack a proper coordination mechanism, which could lead to undermining ongoing efforts when activities are not complementary. Moreover, financial literacy baseline indicators should be established as a way of assessing the impact of future interventions.

B- Collection of Gender Disaggregated Data

This is one of the interventions championed by CBE According to the CBE circular to banks dated 16 August 2018 ¹⁸, a definition of women-owned MSMEs have been formulated and communicated as a basis to collect sex disaggregated data. Program director at INGO (Interviewed in November 2018) highlighted the importance of this step “*establishing a definition of women-owned SMEs is the first step towards having baseline data taking gender into consideration which will be the basis of any future women-targeted policies.* CBE representative (Interviewed in December 2018) added that “*directing banks to collect gender disaggregated data is an eye*

¹⁸ <http://www.cbe.org.eg/en/Pages/HighlightsPages/Circular-dated-16-August-2018-regarding-Women-Owned-Business-Definition.aspx>

opener, it gets banks to consider women and sends an implicit message that the regulator might be focusing on women in future policies. Moreover it gives the chance for the CBE to sit with banks and discuss their strategies and product portfolios for women”.

An establishment of a definition taking gender into consideration is a preliminary step to integrate gender into the financial inclusion policies, as information generated will be the basis of future interventions more geared towards women. Moreover, as suggested by the CBE representative directing banks to segregate their data could be a tool used by the regulator to increase interest of banks in women as target segment with specific needs. Leading to the development of a better value proposition for women-owned MSMEs

C- Capacity Building and Training

Regulators and supervisory authorities should complement their rules and regulations with capacity building efforts to make sure that market players have the necessary capabilities to take advantage of the improved enabling environment.

SME policy advisor (Interviewed in November 2018) reinforced the importance of capacity building as being part of the regulator’s role emphasizing that *“the regulator provided policy incentives as tools for increasing MSME finance, both MSMEs and financial service providers should be ready to use these tools”*. Program director at INGO Interviewed in November (2018) highlighted that *“financial regulators should lead the efforts for building the capacity of financial*

institutions to better serve the MSME market. Banks being the primary financial institutions in Egypt should be the focus of these efforts”.

EBI informant number 1 (Interviewed in November 2018) emphasized the role of EBI as the training arm of the CBE mentioning that *“CBE established the SME unit within EBI with the mandate of developing the banking sector to better deal with the SME segment. The SME unit was established in 2009, when banks had zero to very little engagement in the SME market, banks did not have SME departments nor SME products. SME unit tried to address the mismatch between banks and SMEs, through the following activities:*

- 1- arranging round table discussions between banks and SMEs through chambers of commerce. This is with the aim of introducing SMEs to banks and having a productive discussion on how to deal effectively with each other*
- 2- Assisting banks with the establishment of SME departments through providing them with technical assistance and training their employees on serving the SME market effectively*
- 3- Knowledge transfer: through arranging study tours for bank employees to countries with best practices in SME finance. Preparing debriefing reports after the study tours so that knowledge is shared with all the banks. From 2010 to 2019, EBI has arranged 18 study tours for banks in Egypt.*
- 4- Training SMEs on how to deal with banks, raising their financial awareness and knowledge through introducing them to different banking products and tools”*

SME finance expert (Interviewed in October 2018) highlighted the importance of these capacity building activities *“bringing together SMEs and banks and training bankers on the specific needs of SMEs helps in the development of quality SME products which does not only expand access but also usage of SMEs finance”*. MSME policy advisor (Interviewed in November 2018) argued that

“capacity building training for financial institutions should include a part on advisory services provided by banks, as MSME departments should provide comprehensive solutions to MSMEs not just providing with products but also advising them on the most appropriate tool of financing”. AFI (2016) highlighted the role of the government in capacity building and training of financial institutions especially banks, as training programs provided should address information gaps related to MSMEs and focus on the improvement of advisory services provided by bank employees. This would eventually lead MSMEs to better access financial services and improve their financial capabilities.

As highlighted earlier one the barriers impeding MSMEs financial inclusion is lack of capabilities of banks and financial institutions in dealing with MSMEs and lack of variety of SME finance products. EBI efforts represent an attempt from CBE to address these barriers through trying to raise the internal capabilities of banks to better deal with SMEs and to design products that match SME’s needs thus promoting SME financial inclusion on the long term. Ongoing capacity building and training of banks by EBI could be considered as complementing tools to CBE’s lending regulations aiming to encourage SME finance.

It can be suggested from the above findings that programs aimed at raising bank’s capabilities by EBI are gender neutral, as there were no efforts specifically directed to raise the capabilities of banks to deal better with women or to improve banks ‘overall environment so it could attract women, addressing the specific barrier of lack of demand-based valuable products specifically designed for women

D- Cooperation with NCW on economic and financial empowerment of women

One of the efforts led by the CBE, is a cooperation with NCW through a memorandum of understanding aimed at empowering women economically and financially to promote equal opportunities for women and reinforce women's role as a productive member of the Egyptian society. Expanding financial inclusion of women and more specifically women-owned MSMEs is at the heart of this cooperation addressing the three dimensions of financial inclusion.

NCW representative (Interviewed in November 2018) commented that:

“This cooperation paves the way for the financial inclusion of women with a special focus on women-owned MSMEs. It promotes financial inclusion raising financial awareness and financial education among women, increasing level of savings of women and encouraging women to start their own business, increasing access of formal financial services (specifically banking products) by women through increasing the supply of formal financial services at appropriate price, quality and delivery mechanism , establishing incentives aimed at increasing access to formal financial services and increasing women's usage rates of financial services through promoting the use of technology in marketing financial services and addressing the barriers in reaching services”

The CBE representative (Interviewed in December 2018) elaborated on the CBE's plans to achieve the above-mentioned objectives through the following interventions:

- *Establishing a regulatory and supervisory supportive environment conducive to the promotion of financial inclusion of women, this will be in cooperation with other supervisory and regulatory bodies*
- *Setting incentives for the banking sector to motivate banks to introduce financial services targeting women, especially credit facilities for women-owned MSMEs”*

- *Encouraging banks to develop products specifically for women and setting up programs targeting women aiming at:*
 - *building the awareness of women on the different financial products and teaching them how to use each product effectively*
 - *Encouraging women to open up accounts at banks*
- *Raising financial awareness and financial literacy through the use of modern information technology*
- *Establishing a unified customer service telephone line specifically for women to receive complaints in cooperation with banks*
- *Empowering women in the banking sector and promoting equal opportunities given for women to advance their careers in the financial sector”*

Along with the collection of gender disaggregated data, this was the only intervention which is directly aiming at expanding women’s financial inclusion with a focus on women-owned MSMEs. One can infer that this intervention addresses the comprehensive nature of financial inclusion as it aims at increasing the supply of demand-based products aimed to increase value proposition for women. Moreover, this intervention aims to increase demand by women-owned MSMEs through addressing demand-side barriers like low financial awareness and literacy through developing financial education programs.

Chapter 6: Concluding Remarks and Recommendations

6.1 - Concluding Remarks

The study attempts to explore financial inclusion of women-owned MSMEs in Egypt, the central proposition is that financial inclusion allows access to capital thus promoting growth and productivity. Of all factors of the business environment, access to finance have been identified as one of the most challenging factors affecting MSMEs growth and development. In accordance the aim of this research is to explore barriers challenging expanded access of MSMEs in general with a focus on women-owned MSMEs in Egypt, the role of the government, especially central banks, financial regulatory and supervisory authorities in addressing those barriers, and the nature of the current interventions undertaken on a policy level to promote financially inclusive markets.

The significance of this study lays in the comprehensive approach addressing the concept of financial inclusion, and the potential barriers challenging each dimension of financial inclusion and the current intervention undertaken to address these barriers. This approach highlights areas of improvement for expanding financial inclusion of women-owned MSMEs. Through the use of a qualitative research design and creating a framework for exploring MSME finance, in-depth interviews were carried out and a review of secondary data was undertaken for triangulation purposes.

The main research question of this study, explored ways to include more women-owned MSMEs in the formal financial system in Egypt. The first step to promote financial inclusion of women-owned MSMEs is through addressing barriers impeding financial inclusion of women-owned

MSMEs in Egypt. These barriers were categorized into supply side barriers and demand-side barriers. The main supply-side barriers cited by respondents in this study are risk aversion of banks, limited capabilities of the financial institutions in dealing with women-owned MSMEs, lack of a variety of products designed to meet women's needs, and financial institutions speaking a complicated language. Banks did not intentionally discriminate against women, but they were perceived as a higher risk which led banks to enforce stricter lending guidelines for women. The underlying reasons being that financial institutions had limited relationship with MSMEs and had little awareness of MSMEs needs especially women-owned MSMEs.

Barriers from the demand side were lack of financial awareness and financial literacy among MSMEs and lack of available collateral for borrowing, which is more pronounced for women-owned MSMEs in Egypt.

The second step in promoting financial inclusion of women-owned MSMEs is assessing current interventions on the policy level by CBE and FRA. Those interventions were categorized into three main areas legal and regulatory, financial market infrastructure and market development efforts. Legal and regulatory framework included introducing laws to expand financial inclusion for MSMEs on the banking level including lending guidelines for MSMEs, but also addressing the non-bank financial services including microfinance law, microinsurance, and leasing and factoring law. These policy interventions addressed the main supply-side barriers as it aimed to encourage financial institutions to offer more demand-based products to women-owned MSMEs.

However, the lending guidelines developed by CBE which were the main interventions for MSMEs only addressed price barriers and failed to address other non-price barriers like lack of collateral and strict lending conditions from banks. Moreover, although non-bank financial services laws like the leasing and factoring law would promote the access to financial services, it was not complemented with a financial awareness and literacy strategy to help MSMEs effectively make use of it. All of the policy interventions were not gender-sensitive as they did not take the specific barriers faced by women and different demands of women-owned MSMEs.

Financial market infrastructure interventions included improving the credit information environment through the establishment of I Score and establishing the electronic movable assets registry which all helped in reducing the information asymmetry problems associated with MSMEs. Market development efforts included a demand/supply diagnostic study which focused on MSMEs, households and women. However, the diagnostic study did not address financial literacy and awareness which is one the main barriers identified. Market development efforts included capacity building activities mainly through training programs and support mechanisms through EBI in which none of the programs were directed towards serving women-owned MSMEs. The only two market development activities taking gender differences into consideration were the collection of gender-disaggregated data in order to form a base-line data which can guide future interventions and the agreement with the NCW which is mainly targeting women-owned MSMEs.

6.2 Policy Recommendations

Based on the analysis on women-owned MSMEs and the corresponding constraints they are challenged with, there are considerable number of areas for improvement in addressing these barriers. The following are some advisable improvements to the interventions led by CBE and the financial regulatory authority on the levels of legal and regulatory environment, financial market infrastructure level and direct market development level

➤ **Recommendations on the Level of the Legal and Regulatory Environment**

CBE and FRA

Introduce lending guidelines specifically targeting access for women-owned MSMEs to encourage banks to increase supply of financial products and services specifically designed to meet women's needs. Lending guidelines for women-owned MSMEs can include incentives for banks to increase banks' appetite for women-owned MSMEs which addresses both the profitability of banks and the affordability of financial services. CBE could also allow MFIs to benefit from the reduced interest rates offered by banks to SMEs, which in turn would reflect on better credit conditions for microbusinesses. Moreover, CBE could introduce incentives in the form of lending guidelines that could encourage banks to accept movable assets as collaterals for MSMEs. This would address the major collateral barrier faced by MSMEs.

FRA could also introduce policies to encourage suppliers of non-banking financial services to develop products for MSMEs, more specifically women-owned MSMEs. This would increase the variety of financial products and services available for MSMEs and would decrease MSMEs' dependence on banks as a source of external finance.

➤ **Recommendations on the level of the financial market infrastructure**

FRA & CBE

CBE and FRA could establish action plans to increase the use of the electronic movable assets registry through raising the awareness of the electronic movable assets registry. Offer online training modules on how to use the electronic movable assets registry along with summarizing the benefits of using it.

➤ **Recommendations on the Market Development Level**

CBE

CBE should develop a diagnostic study to assess the level of financial literacy, this will act as a guide for future interventions targeting raising awareness and financial literacy. This is especially important for women, as their low levels of financial literacy was one of the barriers affecting their demand for financial services. As the main financial policy makers CBE should work on building the capacity of financial service providers to better serve women-owned MSMEs this is through training programs that could introduce the importance of serving women as a target segment. Capacity building efforts should be done at all levels, the senior level to put in strategies and outreach mechanism that are better adapted to women, middle management level in order to be able to design products that better suit women's needs and at the level of the loan officers to be able to better assess women's needs and serve them accordingly. Including training programs especially designed to serve and target women in the capacity building efforts done through EBI that way banks would consider targeting women, after having the tools and capabilities to serve them.

FRA

Build an awareness campaign specifically addressing non-banking financial services highlighting benefits for MSMEs.

CBE and FRA

Introduce a reward for the best bank or financial service provider which serves the most women or offer the best products to women or design their operations to fit women's needs. Winner of the reward to be publicized in the market on a broad level. This may encourage financial institutions to approach the women's segment.

Policymakers: NCW in coordination with CBE & FRA

Building the capacity of women-owned MSMEs to be able to better use financial services and products. Capacity building efforts designed for women-owned MSMEs should be segmented by size of the organization because every size has different needs and face different challenges.

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